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# AICPA Professional Standards: Quality control as of June 1, 1982;

American Institute of Certified Public Accountants. Quality Control Standards Committee;

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**QC Section****QUALITY CONTROL**

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**QC Section**

# STATEMENTS ON QUALITY CONTROL STANDARDS

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*Statements on quality control standards are issued by the quality control standards committee, the senior technical committee of the Institute designated to issue pronouncements on quality control standards. Firms that are members of the AICPA Division for CPA Firms are obligated to adhere to quality control standards promulgated by the Institute. All AICPA members should be aware that they may be called upon to justify departures from this statement.*

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**QC Section 10****System of Quality Control  
for a CPA Firm**

(This statement provides that a CPA firm shall have a system of quality control and describes elements of quality control and other matters essential to the effective implementation of the system.)

November 1979

**.01** Quality control for a CPA firm, as referred to in this statement, applies to all auditing and accounting and review services for which professional standards have been established.<sup>1</sup> Although the provisions of this statement may be applied to other segments of a firm's practice, such as providing tax services or management advisory services, their applicability to those segments of practice is not prescribed by this statement, except to the extent that such services are a part of the abovementioned auditing and accounting and review services.

**.02** In providing professional services, a firm has a responsibility to conform with professional standards. In accepting this responsibility, there is a presumption that the firm will consider the integrity of individuals in determining its professional relationships, that the firm and its people will be independent of its clients to the extent required by the AICPA's rules of conduct, and that the firm's personnel will be professionally competent, will be objective, and will exercise due professional care.<sup>2</sup> To provide itself with reasonable assurance of meeting its responsibility to provide professional services that conform with professional standards, a firm shall have a system of quality control.

**System of Quality Control**

**.03** A system of quality control for a firm encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of conforming with profes-

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1. *Firm* is defined in the AICPA rules of conduct as "A proprietorship, partnership, or professional corporation or association engaged in the practice of public accounting, including individual partners or shareholders thereof." *Professional standards*, as referred to in this statement, are those that relate to the professional qualities and performance of individual members of the AICPA and, accordingly, include the rules of conduct of the AICPA, pronouncements of the AICPA Auditing Standards Board and its predecessor committees, and pronouncements of the AICPA Accounting and Review Services Committee.

2. Unless the text states otherwise, the term *personnel* encompasses all of a firm's professionals performing services to which this statement applies and includes proprietors, partners, principals, and stockholders or officers of professional corporations, and their professional employees.

sional standards. The system of quality control should be appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice.

**.04** Any system of quality control has inherent limitations that can reduce its effectiveness. Variance in individual performance and understanding of professional requirements affects the degree of compliance with a firm's prescribed quality control policies and procedures and, therefore, the effectiveness of the system.

**.05** The system of quality control for a U.S. firm should provide the firm with reasonable assurance that the segments of the firm's engagements performed by its foreign offices or by its domestic or foreign affiliates or correspondents are performed in accordance with professional standards in the United States.<sup>3</sup>

### **Establishment of Quality Control Policies and Procedures**

**.06** The nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.<sup>4</sup>

**.07** A firm shall consider each of the elements of quality control discussed below, to the extent applicable to its practice, in establishing its quality control policies and procedures. The elements of quality control are inter-related. Thus, a firm's hiring practices affect its policies as to training. Training practices affect policies as to promotion. Practices in both categories affect policies as to supervision. Practices as to supervision, in turn, affect policies as to training and promotion.

- a. *Independence.* Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA. Rule 101 [ET section 101.01] of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.

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3. SAS No. 1, section 543 [AU section 543], provides guidance regarding procedures to be considered on individual audit engagements when the principal auditor utilizes the work of other auditors.

4. *Quality Control Policies and Procedures for CPA Firms* [QC section 90], may be useful to a firm in considering its quality control policies and procedures.

- b. *Assigning Personnel to Engagements.*** Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.
- c. *Consultation.*** Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.
- d. *Supervision.*** Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.
- e. *Hiring.*** Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.
- f. *Professional Development.*** Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.
- g. *Advancement.*** Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important implica-

tions for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.

- h. Acceptance and Continuance of Clients.* Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships.
- i. Inspection.* Policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.

## **Assignment of Responsibilities**

**.08** A firm shall assign responsibilities to its personnel to the extent required to effectively implement its quality control policies and procedures. In the assignment of responsibilities, appropriate consideration should be given to the competence of the individuals, the authority delegated to them, and the extent of supervision provided.

## **Communication**

**.09** A firm shall communicate to its personnel its quality control policies and procedures in a manner that will provide reasonable assurance that such policies and procedures are understood. The form and extent of such communication should be sufficiently comprehensive to provide the firm's personnel with information concerning the quality control policies and procedures applicable to them. Although communication ordinarily is enhanced if the communication is in writing, the effectiveness of a firm's system of quality control is not necessarily impaired by the absence of documentation of established quality control policies and procedures. The size, structure, and nature of practice of the firm should be considered in determining whether documentation of quality control policies and procedures is required and, if so, the extent of such documentation. Normally, documentation of quality control policies and procedures would be expected to be more extensive in a larger firm than in a smaller firm and more extensive in a multi-office firm than in a single-office firm.

## Monitoring

**.10** A firm shall monitor the effectiveness of its system of quality control by evaluating on a timely basis its quality control policies and procedures, assignment of responsibilities, and communication of policies and procedures. The size, structure, and nature of practice of a firm influence both the requirements and the limitations of its monitoring function. Implicit in the monitoring function is timely modification of policies and procedures, assignment of responsibilities, and the form and extent of communication, as required by new authoritative pronouncements or by other changes in circumstances, including those resulting from expansion of practice or opening of offices, merging of firms, or acquiring of practices. Monitoring activities include, but are not limited to, the quality control element of inspection.

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**QC Section**

# INTERPRETATIONS OF QUALITY CONTROL STANDARDS

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*Interpretations of Quality Control Standards are issued by the Quality Control Standards Committee, the senior technical committee of the Institute designated to issue pronouncements on Quality Control Standards. Interpretations do not have the authority of Statements on Quality Control Standards issued by the AICPA Quality Control Standards Committee. However, members of the AICPA and member firms of the Division for CPA Firms should be aware that they may be called upon to justify departures from interpretations.*

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## QC Section 10-1

# ***System of Quality Control for a CPA Firm: Interpretations of QC Section 10***

### **1. The Relationship Between Inspection and Monitoring**

.01 *Question.* What is the relationship between inspection and monitoring?

.02 *Interpretation.* The objective of monitoring is to determine on a timely basis that the firm's quality control policies and procedures, assignment of responsibilities, and communication of policies and procedures continue to be appropriate. The objective of inspection is to determine compliance with quality control policies and procedures in effect during a period of time. Inspection procedures contribute to the monitoring function because findings, which may indicate the need to modify quality control policies or procedures, are evaluated and changes are considered. Other events such as new authoritative pronouncements or other changes in circumstances, including those resulting from expansion of practice or opening of offices, mergers of firms, acquiring of practices, or separations of significant portions of a firm or its key personnel, may also indicate a need for change in quality control policies and procedures.

[Issue Date: July, 1980.]

### **2. Implementation of Inspection in CPA Firms**

.03 Statement on Quality Control Standards No. 1 [section 10] indicates that "policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures." Additionally, the guide *Quality Control Policies and Procedures for CPA Firms—Establishing Quality Control Policies and Procedures* [section 90] offers examples of how to implement quality control policies and procedures for the element of inspection.

.04 *Question.* How is inspection implemented?

.05 *Interpretation.* Inspection is implemented by performing the following at least each year:

- Review administrative and personnel files to determine whether there is reasonable assurance that the firm's quality control policies and procedures are being complied with.
- Review engagement working papers, files, and reports to determine whether there is reasonable assurance that the firm's quality control policies and procedures and professional standards are being complied with.

.06 Inspection procedures should be applied to the extent necessary to provide the firm with reasonable assurance that its quality control policies and procedures are being complied with. Thus, inspection procedures should be applied to each element of quality control and may be on a test basis.

.07 The performance of inspection procedures may result in information useful in performing the monitoring function.

.08 Inspection findings should be considered by appropriate firm management personnel. The firm should implement appropriate action as a result of inspection findings and should follow up to determine that planned actions were taken.

.09 A firm's inspection policies and procedures may provide that a peer review conducted under the AICPA Division for CPA Firms fulfills the firm's annual inspection requirements for the year covered by the peer review. However, standards for performing peer reviews issued by the SEC and Private Companies Practice Sections of the AICPA Division for CPA Firms provide that the scope of the peer review may be affected by the review team's evaluation of the scope and adequacy of the firm's inspection program.

.10 *Question.* Does the element of inspection apply to all CPA firms including sole practitioners, with or without professional staff?

.11 *Interpretation.* The element of inspection applies to all CPA firms, including sole practitioners with or without professional staff.

.12 *Question.* How can inspection be implemented in sole practitioner CPA firms?

.13 *Interpretation.* Statement on Quality Control Standards No. 1 [section 10] indicates that the type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures. It further indicates that procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. Such individuals may be members of the sole practitioner's professional staff or be from outside the firm.

.14 A sole practitioner with or without professional staff may inspect his firm's compliance with his own policies and procedures. In performing such inspection procedures the practitioner may utilize checklists developed by the AICPA or other relevant materials.

.15 Alternatively, sole practitioner CPA firms with or without professional staff may engage a qualified individual or firm to perform inspection procedures. Two firms, including sole practitioners, may provide inspection procedures for one another.

.16 *Question.* How can inspection be implemented in other CPA firms that do not have internal personnel other than those responsible for the functional areas (elements of quality control) or engagements to perform inspection procedures?

.17 *Interpretation.* Such firms may employ the same procedures as set forth above [paragraphs .10—.15] for sole practitioners with or without professional staff.

.18 *Question.* Are there circumstances under which preissuance engagement review procedures may be considered part of the firm's inspection program?

.19 *Interpretation.* The engagement partner's review of working papers, files, and reports does not constitute inspection. However, if a firm uses the supervision procedure of a second management-level preissuance review of engagement working papers, files, and reports, such procedures may compensate for certain post issuance inspection procedures, and, therefore, could substitute for a part of the firm's inspection program. Such review should be the equivalent of the review the firm would have performed as an inspection procedure after issuance of the report to determine compliance with quality control policies and procedures and professional standards. Findings as a result of such reviews, since they should be equivalent to inspection findings, should be periodically summarized and considered by appropriate firm management personnel. The firm should implement appropriate action as a result of such findings and should follow up to determine that planned actions were taken. The firm would additionally need to review compliance with respect to each element of its quality control system at least each year.

[Issue Date: July, 1980.]

### **3. Documentation of Compliance with a System of Quality Control**

.20 *Question.* In connection with the element of inspection, the Quality Control Standards Committee has been asked to clarify paragraph 7 (i) of Statement on Quality Control Standards No. 1 [section 10.07(i)] as to whether and to what extent documentation would

ordinarily be required "to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied."

.21 *Interpretation.* Statement on Quality Control Standards No. 1 [section 10] states: "The nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations." Although Statement on Quality Control Standards No. 1 [section 10] does not specifically refer to documentation of compliance, a firm ordinarily should require the preparation and maintenance of appropriate documentation to demonstrate compliance with its policies and procedures for the elements of quality control discussed in Statement on Quality Control Standards No. 1 [section 10]. The form and extent of such documentation depend on a number of factors such as the size of a firm, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations. However, documentation should be sufficient to enable those conducting an inspection to ascertain the extent of a firm's compliance with its system of quality control, including its compliance with inspection policies and procedures.

[Issue Date: June, 1982.]

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**QC Section**

# QUALITY CONTROL POLICIES AND PROCEDURES FOR CPA FIRMS

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## NOTICE TO READERS

This guide is being issued by the AICPA Quality Control Standards Committee to provide guidance for the application in practice of Statement on Quality Control Standards 1. It does not have the authority of a pronouncement by the AICPA Quality Control Standards Committee. However, members of the AICPA and member firms of the division for CPA firms should be aware that they may be called upon to justify departures from the guide.

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➡ The next page is 17,217. ⬅

**QC Section 90****Establishing Quality Control  
Policies and Procedures****Introduction**

.01 A system of quality control for a CPA firm, as described in Statement on Quality Control Standards 1 [section 10], encompasses quality control policies and procedures, assignment of responsibilities, communication, and monitoring. This guide provides guidance for the establishment of quality control policies and procedures in accordance with paragraphs 6 and 7 of Statement on Quality Control Standards 1 [section 10.06—.07], *System of Quality Control for a CPA Firm*.

.02 Those paragraphs provide that the nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the degree of operating autonomy allowed its personnel and its practice offices, the nature of its practice, its organization, and appropriate cost-benefit considerations.

.03 A firm shall consider each of the elements of quality control, to the extent applicable to its practice, in establishing its quality control policies and procedures. Certain of the elements of quality control are interrelated. Thus, a firm's hiring practices affect its policies as to training. Training practices affect policies as to promotion. Practices in both categories affect policies as to supervision. Practices as to supervision, in turn, affect policies as to training and promotion.

.04 The terms *firm*, *professional standards*, and *personnel*, as used in this guide, are defined in Statement on Quality Control Standards 1 [section 10]. The term *policies* refers to a CPA firm's objectives and goals for effecting the elements of quality control. *Procedures* refers to the steps to be taken to accomplish the policies adopted.

.05 The elements of quality control are identified in Statement on Quality Control Standards 1 [section 10] and are discussed in this document under the following designations:



- Independence
- Assigning Personnel to Engagements
- Consultation
- Supervision
- Hiring
- Professional Development
- Advancement
- Acceptance and Continuance of Clients
- Inspection

.06 A firm should consider establishing policies in the areas identified under each element of quality control discussed herein to the extent such policies are applicable to its practice. Illustrative examples of procedures designed to implement the policies adopted are also presented. The specific procedures used by a firm would not necessarily include all those illustrated or be limited to them.

.07 Some regulatory agencies have promulgated requirements for compliance with independence or other standards that are applicable to professionals practicing before them. Therefore, a firm should adopt policies and procedures to provide reasonable assurance of compliance with the requirements of the regulatory agencies before which it practices.

.08 When firms merge or when a firm acquires a practice, the combined firm should give special attention to quality control considerations. The combined firm's quality control policies and procedures should be evaluated to determine that they continue to be applicable in light of the changed circumstances. Similar attention should be given to quality control considerations when a firm is divided.

## **Independence**

.09 Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA. Rule 101 [ET section 101.01] of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.

***Policies and Procedures***

.10 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Require that personnel at all organizational levels adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, state CPA society, state board of accountancy, state statute, and, if applicable, the Securities and Exchange Commission and other regulatory agencies.<sup>1</sup>**
  - a. Designate an individual or group to provide guidance and to resolve questions on independence matters.
    - (i) Identify circumstances where documentation of the resolution of questions would be appropriate.
    - (ii) Require consultation with authoritative sources when considered necessary.
2. **Communicate policies and procedures relating to independence to personnel at all organizational levels.**
  - a. Inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with these policies and procedures.
  - b. Emphasize independence of mental attitude in training programs and in supervision and review of engagements.
  - c. Apprise personnel on a timely basis of those entities to which independence policies apply.
    - (i) Prepare and maintain for independence purposes a list of the firm's clients and of other entities (client's affiliates, parents, associates, and so forth) to which independence policies apply.
    - (ii) Make the list available to personnel (including personnel new to the firm or to an office) who need it to determine their independence.
    - (iii) Establish procedures to notify personnel of changes in the list.
  - d. Maintain a library or other facility containing professional, regulatory, and firm literature relating to independence matters.

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1. In some cases, a firm may wish to establish other requirements that it deems appropriate, for example, concerning prohibited transactions or relationships.

3. **Confirm, when acting as principal auditor, the independence of another firm engaged to perform segments of an engagement.<sup>2</sup>**
  - a. Inform personnel about the form and content of an independence representation that is to be obtained from a firm that has been engaged to perform segments of an engagement.
  - b. Advise personnel about the frequency with which a representation should be obtained from an affiliate or associate firm for a repeat engagement.
4. **Monitor compliance with policies and procedures relating to independence.**
  - a. Obtain from personnel periodic, written representations, normally on an annual basis, stating that—
    - (i) They are familiar with the firm's independence policies and procedures.
    - (ii) Prohibited investments are not held and were not held during the period. As an alternative or additional procedure, a firm may obtain listings of investments and securities transactions (numbers of shares or dollar amounts need not be included) from personnel to determine that there are no prohibited holdings.
    - (iii) Prohibited relationships do not exist, and transactions prohibited by firm policy have not occurred.
  - b. Assign responsibility for resolving exceptions to a person or group with appropriate authority.
  - c. Assign responsibility for obtaining representations and reviewing independence compliance files for completeness to a person or group with appropriate authority.
  - d. Review periodically accounts receivable from clients to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

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2. If a firm utilizes the services of a related, affiliated, or associated firm, the principal firm may obtain periodically (frequently annually) a representation from the other firm covering all referred engagements or may include the representation as part of a continuing agreement.

If a firm other than an affiliate or associate is retained, representation should be received for each engagement.

In the case of an international engagement, the representation from the foreign firm should make reference to U. S. independence standards.

## Assigning Personnel to Engagements

.11 Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.

### *Policies and Procedures*

.12 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Delineate the firm's approach to assigning personnel, including the planning of overall firm and office needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.**
  - a. Plan the personnel needs of the firm on an overall basis and for individual practice offices.
  - b. Identify on a timely basis the staffing requirements of specific engagements.
  - c. Prepare time budgets for engagements to determine manpower requirements and to schedule field work.
  - d. Consider the following factors in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:
    - (i) Engagement size and complexity.
    - (ii) Personnel availability.
    - (iii) Special expertise required.
    - (iv) Timing of the work to be performed.
    - (v) Continuity and periodic rotation of personnel.
    - (vi) Opportunities for on-the-job training.
2. **Designate an appropriate person or persons to be responsible for assigning personnel to engagements.**

- a. Consider the following in making assignments of individuals:
    - (i) Staffing and timing requirements of the specific engagement.
    - (ii) Evaluations of the qualifications of personnel regarding experience, position, background, and special expertise.
    - (iii) The planned supervision and involvement by supervisory personnel.
    - (iv) Projected time availability of individuals assigned.
    - (v) Situations where possible independence problems and conflicts of interest may exist, such as assignment of personnel to engagements for clients who are former employers or are employers of certain kin.
  - b. Give appropriate consideration, in assigning personnel, to both continuity and rotation to provide for efficient conduct of the engagement and the perspective of other personnel with different experience and backgrounds.
3. **Provide for approval of the scheduling and staffing of the engagement by the person with final responsibility for the engagement.**
- a. Submit, where necessary, for review and approval the names and qualifications of personnel to be assigned to an engagement.
  - b. Consider the experience and training of the engagement personnel in relation to the complexity or other requirements of the engagement and the extent of supervision to be provided.

## **Consultation**

.13 Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.

***Policies and Procedures***

.14 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- 1. Identify areas and specialized situations where consultation is required, and encourage personnel to consult with or use authoritative sources on other complex or unusual matters.**
  - a. Inform personnel of the firm's consultation policies and procedures.
  - b. Specify areas or specialized situations requiring consultation because of the nature or complexity of the subject matter. Examples include—
    - (i) Application of newly issued technical pronouncements.
    - (ii) Industries with special accounting, auditing, or reporting requirements.
    - (iii) Emerging practice problems.
    - (iv) Choices among alternative generally accepted accounting principles when an accounting change is to be made.
    - (v) Filing requirements of regulatory agencies.
  - c. Maintain or provide access to adequate reference libraries and other authoritative sources.
    - (i) Establish responsibility for maintaining a reference library in each practice office.
    - (ii) Maintain technical manuals and issue technical pronouncements, including those relating to particular industries and other specialties.
    - (iii) Maintain consultation arrangements with other firms and individuals where necessary to supplement firm resources.
    - (iv) Refer problems to a division or group in the AICPA or state CPA society established to deal with technical inquiries.
  - d. Maintain a research function to assist personnel with practice problems.
- 2. Designate individuals as specialists to serve as authoritative sources, and define their authority in consultative situa-**

**tions. Provide procedures for resolving differences of opinion between engagement personnel and specialists.**

- a. Designate individuals as specialists for filings with the Securities and Exchange Commission and other regulatory agencies.
  - b. Designate specialists for particular industries.
  - c. Advise personnel of the degree of authority to be accorded specialists' opinions and of the procedures to be followed for resolving differences of opinion with specialists.
  - d. Require documentation of the considerations involved in the resolution of differences of opinion.
- 3. Specify the extent of documentation to be provided for the results of consultation in those areas and specialized situations where consultation is required. Specify documentation, as appropriate, for other consultations.**
- a. Advise personnel about the extent of documentation to be prepared and the responsibility for its preparation.
  - b. Indicate where consultation documentation is to be maintained.
  - c. Maintain subject files containing the results of consultations for reference and research purposes.

## **Supervision**

**.15** Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.

### ***Policies and Procedures***

**.16** A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Exam-

ples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

**1. Provide procedures for planning engagements.**

- a. Assign responsibility for planning an engagement. Involve appropriate personnel assigned to the engagement in the planning process.
- b. Develop background information or review information obtained from prior engagements and update for changed circumstances.
- c. Describe matters to be included in the engagement planning process, such as the following:
  - (i) Development of proposed work programs.
  - (ii) Determination of manpower requirements and need for specialized knowledge.
  - (iii) Development of estimates of time required to complete the engagement.
  - (iv) Consideration of current economic conditions affecting the client or its industry and their potential impacts on the conduct of the engagement.

**2. Provide procedures for maintaining the firm's standards of quality for the work performed.**

- a. Provide adequate supervision at all organizational levels, considering the training, ability, and experience of the personnel assigned.
- b. Develop guidelines for the form and content of working papers.
- c. Utilize standardized forms, checklists, and questionnaires to the extent appropriate to assist in the performance of engagements.
- d. Provide procedures for resolving differences of professional judgment among members of an engagement team.

**3. Provide procedures for reviewing engagement working papers and reports.**

- a. Develop guidelines for review of working papers and for documentation of the review process.
  - (i) Require that reviewers have appropriate competence and responsibility.
  - (ii) Determine that work performed is complete and conforms to professional standards and firm policy.



- (iii) Describe documentation evidencing review of working papers and the reviewer's findings. Documentation may include initialing working papers, completing a reviewer's questionnaire, preparing a reviewer's memorandum, and employing standard forms or checklists.
- b. Develop guidelines for review of the report to be issued for an engagement. Considerations in *a*, above, would be applicable to this review. In addition, the following matters should be considered for these guidelines:
  - (i) Determine that the evidence of work performed and conclusions contained in the working papers support the report.
  - (ii) Determine that the report conforms to professional standards and firm policy.
  - (iii) Provide for review of the report by an appropriate individual having no other responsibility for the engagement.

## Hiring

.17 Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.

### *Policies and Procedures*

.18 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Maintain a program designed to obtain qualified personnel by planning for personnel needs, establishing hiring objectives, and setting qualifications for those involved in the hiring function.**
  - a. Plan for the firm's personnel needs at all levels and establish quantified hiring objectives based on current clientele,

anticipated growth, personnel turnover, individual advancement, and retirement.

- b. Design a program to achieve hiring objectives which provides for—
  - (i) Identification of sources of potential hirees.
  - (ii) Methods of contact with potential hirees.
  - (iii) Methods of specific identification of potential hirees.
  - (iv) Methods of attracting potential hirees and informing them about the firm.
  - (v) Methods of evaluating and selecting potential hirees for extension of employment offers.
- c. Inform those persons involved in hiring about the firm's personnel needs and hiring objectives.
- d. Assign to authorized persons the responsibility for employment decisions.
- e. Monitor the effectiveness of the recruiting program.
  - (i) Evaluate the recruiting program periodically to determine whether policies and procedures for obtaining qualified personnel are being observed.
  - (ii) Review hiring results periodically to determine whether goals and personnel needs are being achieved.

**2. Establish qualifications and guidelines for evaluating potential hirees at each professional level.**

- a. Identify the attributes to be sought in hirees, such as intelligence, integrity, honesty, motivation, and aptitude for the profession.
- b. Identify achievements and experiences desirable for entry-level and experienced personnel; for example—
  - (i) Academic background.
  - (ii) Personal achievements.
  - (iii) Work experience.
  - (iv) Personal interests.
- c. Set guidelines to be followed when hiring individuals in atypical situations, such as—
  - (i) Hiring relatives of personnel or relatives of clients.
  - (ii) Rehiring former employees.
  - (iii) Hiring client employees.
- d. Obtain background information and documentation of qualifications of applicants by appropriate means, such as—
  - (i) Resumes.
  - (ii) Application forms.

- (iii) Interviews.
    - (iv) College transcripts.
    - (v) Personal references.
    - (vi) Former employment references.
  - e. Evaluate the qualifications of new personnel, including those obtained from other than the usual hiring channels (for example, those joining the firm at supervisory levels or through merger or acquisition), to determine that they meet the firm's requirements and standards.
- 3. Inform applicants and new personnel of the firm's policies and procedures relevant to them.**
- a. Use a brochure or another means to so inform applicants and new personnel.
  - b. Prepare and maintain a manual describing policies and procedures for distribution to personnel.
  - c. Conduct an orientation program for new personnel.

## **Professional Development**

.19 Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.

### ***Policies and Procedures***

.20 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

- 1. Establish guidelines and requirements for the firm's professional development program and communicate them to personnel.**
  - a. Assign responsibility for the professional development function to a person or group with appropriate authority.

- b. Provide that programs developed by the firm be reviewed by qualified individuals. Programs should contain statements of objectives and education and/or experience prerequisites.
  - c. Provide an orientation program relating to the firm and the profession for newly employed personnel.
    - (i) Prepare publications and programs designed to inform newly employed personnel of their professional responsibilities and opportunities.
    - (ii) Designate responsibility for conducting orientation conferences to explain professional responsibilities and firm policies.
    - (iii) Enable newly employed personnel with limited experience to attend the AICPA or other comparable-level staff training programs.
  - d. Establish continuing professional education requirements for personnel at each level within the firm.
    - (i) Consider state mandatory requirements or voluntary guidelines in establishing firm requirements.
    - (ii) Encourage participation in external continuing professional education programs, including college-level and self-study courses.
    - (iii) Encourage membership in professional organizations. Consider having the firm pay or contribute toward membership dues and expenses.
    - (iv) Encourage personnel to serve on professional committees, prepare articles, and participate in other professional activities.
  - e. Monitor continuing professional education programs and maintain appropriate records, on both a firm and an individual basis.
    - (i) Review periodically the records of participation by personnel to determine compliance with firm requirements.
    - (ii) Review periodically evaluation reports and other records prepared for continuing education programs to evaluate whether the programs are being presented effectively and are accomplishing firm objectives. Consider the need for new programs and for revision or elimination of ineffective programs.
2. **Make available to personnel information about current developments in professional technical standards and materials containing the firm's technical policies and procedures and encourage personnel to engage in self-development activities.**

- a. Provide personnel with professional literature relating to current developments in professional technical standards.
    - (i) Distribute to personnel material of general interest, such as pronouncements of the Financial Accounting Standards Board and the AICPA Auditing Standards Board.
    - (ii) Distribute pronouncements in areas of specific interest, such as those issued by the Securities and Exchange Commission, Internal Revenue Service, and other regulatory agencies to persons who have responsibility in such areas.
    - (iii) Distribute manuals containing firm policies and procedures on technical matters to personnel. Manuals should be updated for new developments and changing conditions.
  - b. For training programs presented by the firm, develop or obtain course materials and select and train instructors.
    - (i) State the program objectives and education and/or experience prerequisites in the training programs.
    - (ii) Provide that program instructors be qualified in both program content and teaching methods.
    - (iii) Have participants evaluate program content and instructors of training sessions.
    - (iv) Have instructors evaluate program content and participants in training sessions.
    - (v) Update programs as needed in light of new developments, changing conditions, and evaluation reports.
- 3. Provide, to the extent necessary, programs to fill the firm's needs for personnel with expertise in specialized areas and industries.**
- a. Conduct firm programs to develop and maintain expertise in specialized areas and industries, such as regulated industries, computer auditing, and statistical sampling methods.
  - b. Encourage attendance at external education programs, meetings, and conferences to acquire technical or industry expertise.
  - c. Encourage membership and participation in organizations concerned with specialized areas and industries.
  - d. Provide technical literature relating to specialized areas and industries.
- 4. Provide for on-the-job training during the performance of engagements.**

- a. Emphasize the importance of on-the-job training as a significant part of an individual's development.
  - (i) Discuss with assistants the relationship of the work they are performing to the engagement as a whole.
  - (ii) Involve assistants in as many portions of the engagement as practicable.
- b. Emphasize the significance of personnel management skills and include coverage of these subjects in firm training programs.
- c. Encourage personnel to train and develop subordinates.
- d. Monitor assignments to determine that personnel—
  - (i) Fulfill, where applicable, the experience requirements of the state board of accountancy.
  - (ii) Gain experience in various areas of engagements and varied industries.
  - (iii) Work under different supervisory personnel.

## **Advancement**

.21 Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important implications for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.

### ***Policies and Procedures***

.22 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Establish qualifications deemed necessary for the various levels of responsibility within the firm.**
  - a. Prepare guidelines describing responsibilities at each level and expected performance and qualifications necessary for advancement to each level, including—

- (i) Titles and related responsibilities.
    - (ii) The amount of experience (which may be expressed as a time period) generally required for advancement to the succeeding level.
  - b. Identify criteria that will be considered in evaluating individual performance and expected proficiency, such as the following:
    - (i) Technical knowledge.
    - (ii) Analytical and judgmental abilities.
    - (iii) Communicative skills.
    - (iv) Leadership and training skills.
    - (v) Client relations.
    - (vi) Personal attitude and professional bearing (character, intelligence, judgment, and motivation).
    - (vii) Possession of a CPA certificate for advancement to a supervisory position.
  - c. Use a personnel manual or other means to communicate advancement policies and procedures to personnel.
- 2. Evaluate performance of personnel, and periodically advise personnel of their progress. Maintain personnel files containing documentation relating to the evaluation process.**
- a. Gather and evaluate information on performance of personnel.
    - (i) Identify evaluation responsibilities and requirements at each level indicating who will prepare evaluations and when they will be prepared.
    - (ii) Instruct personnel on the objectives of personnel evaluation.
    - (iii) Utilize forms, which may be standardized, for evaluating performance of personnel.
    - (iv) Review evaluations with the individual being evaluated.
    - (v) Require that evaluations be reviewed by the evaluator's superior.
    - (vi) Review evaluations to determine that individuals worked for and were evaluated by different persons.
    - (vii) Determine that evaluations are completed on a timely basis.
  - b. Periodically counsel personnel regarding their progress and career opportunities.

- (i) Review periodically with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include the following:
    - (a) Performance.
    - (b) Future objectives of the firm and the individual.
    - (c) Assignment preferences.
    - (d) Career opportunities.
  - (ii) Evaluate partners periodically by means of counseling, peer evaluation, or self appraisal, as appropriate, regarding whether they continue to have the qualifications to fulfill their responsibilities.
  - (iii) Review periodically the system of personnel evaluation and counseling to ascertain that—
    - (a) Procedures for evaluation and documentation are being followed on a timely basis.
    - (b) Requirements established for advancement are being achieved.
    - (c) Personnel decisions are consistent with evaluations.
    - (d) Recognition is given to outstanding performance.
- 3. Assign responsibility for making advancement decisions.**
- a. Assign responsibility to designated persons for making advancement and termination decisions, conducting evaluation interviews with persons considered for advancement, documenting the results of the interviews, and maintaining appropriate records.
  - b. Evaluate data obtained giving appropriate recognition in advancement decisions to the quality of the work performed.
  - c. Study the firm's advancement experience periodically to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility.

## **Acceptance and Continuance of Clients**

.23 Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients.



However, prudence suggests that a firm be selective in determining its professional relationships.

### ***Policies and Procedures***

.24 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

#### **1. Establish procedures for evaluation of prospective clients and for their approval as clients.**

- a. Consider evaluation procedures such as the following before accepting a client:
  - (i) Obtain and review available financial information regarding the prospective client, such as annual reports, interim financial statements, registration statements, Forms 10-K, other reports to regulatory agencies, and income tax returns.
  - (ii) Inquire of third parties about any information regarding the prospective client and its management and principals that may have a bearing on evaluating the prospective client. Inquiries may be directed to the prospective client's bankers, legal counsel, investment banker, underwriter, and others in the financial or business community who may have such knowledge. Credit reports may also be useful.
  - (iii) Communicate with the predecessor auditor as required by auditing standards. Inquiries should include questions regarding facts that might bear on the integrity of management, on disagreements with management regarding accounting principles, auditing procedures, or other similarly significant matters, and on the predecessor's understanding of the reasons for the change of auditors.
  - (iv) Consider circumstances that would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.
  - (v) Evaluate the firm's independence and ability to service the prospective client. In evaluating the firm's ability, consider needs for technical skills, knowledge of the industry, and personnel.

- (vi) Determine that acceptance of the client would not violate applicable regulatory agency requirements and the codes of professional ethics of the AICPA or a state CPA society.
  - b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained regarding the prospective client and to make the acceptance decision.
    - (i) Consider types of engagements that the firm would not accept or that would be accepted only under certain conditions.
    - (ii) Provide for documentation of the conclusion reached.
  - c. Inform appropriate personnel of the firm's policies and procedures for accepting clients.
  - d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for acceptance of clients.
- 2. Evaluate clients at the end of specific periods or upon the occurrence of specified events to determine whether the relationships should be continued.**
- a. Specify conditions that require evaluation of a client to determine whether the relationship should be continued. Conditions could include—
    - (i) Expiration of a time period.
    - (ii) Significant change since the last evaluation, including a major change in one or more of the following:
      - (a) Management.
      - (b) Directors.
      - (c) Ownership.
      - (d) Legal counsel.
      - (e) Financial condition.
      - (f) Litigation status.
      - (g) Nature of the client's business.
      - (h) Scope of the engagement.
    - (iii) The existence of conditions that would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.
  - b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained and to make continuance decisions.
    - (i) Consider types of engagements that the firm would not continue or that would be continued only under certain conditions.

- (ii) Provide for documentation of the conclusion reached.
- c. Inform appropriate personnel of the firm's policies and procedures for continuing clients.
- d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for continuance of clients.

## Inspection

.25 Policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.

### *Policies and Procedures*

.26 A firm should give consideration to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. **Define the scope and content of the firm's inspection program.**
  - a. Determine the inspection procedures necessary to provide reasonable assurance that the firm's other quality control policies and procedures are operating effectively.
    - (i) Determine objectives and prepare instructions and review programs for use in conducting inspection activities.
    - (ii) Provide guidelines for the extent of work at practice units, functions, or departments, and criteria for selection of engagements for review.
    - (iii) Establish the frequency and timing of inspection activities.
    - (iv) Establish procedures to resolve disagreements that may arise between reviewers and engagement or management personnel.

- b. Establish qualifications for personnel to participate in inspection activities and the method of their selection.
    - (i) Determine criteria for selecting reviewers, including levels of responsibility in the firm and requirements for specialized knowledge.
    - (ii) Assign responsibility for selecting inspection personnel.
  - c. Conduct inspection activities at practice units, functions, or departments.
    - (i) Review and test compliance with applicable quality control policies and procedures.
    - (ii) Review selected engagements for compliance with professional standards, including generally accepted auditing standards, generally accepted accounting principles, and with the firm's quality control policies and procedures.
- 2. Provide for reporting inspection findings to the appropriate management levels and for monitoring actions taken or planned.**
- a. Discuss inspection review findings on engagements reviewed with engagement management personnel.
  - b. Discuss inspection findings of practice units, functions, or departments reviewed with appropriate management personnel.
  - c. Report inspection findings and recommendations to firm management together with corrective actions taken or planned.
  - d. Determine that planned corrective actions were taken.

**➡ The next page is 17,267. ⬅**

## Preface

This division contains the following sections which pertain to the Voluntary Quality Control Review Program for CPA Firms:

- *Voluntary Quality Control Review Program for CPA Firms*, which was approved by Council on October 23, 1976.
- *Scope of the Quality Control Document Review*.
- *Quality Control Policies and Procedures for Participating CPA Firms*.
- *Performing and Reporting on Quality Control Compliance Reviews*.

The Voluntary Quality Control Review Program is designed solely to serve CPA firms which are not members of the AICPA Division for CPA Firms. The standards for peer reviews of members of the division are being promulgated separately by the respective peer review committees of the SEC Practice Section and the Private Companies Practice Section.

Wallace E. Olson  
President  
May, 1978

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**QC Section**

# **VOLUNTARY QUALITY CONTROL REVIEW PROGRAM FOR CPA FIRMS**

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## ***Voluntary Quality Control Review Program for CPA Firms***

### **Introduction**

.01 An important part of the profession's system of self-regulation is to see that CPA firms maintain adequate systems of quality control. This is necessary because quality control is a vital element of the profession's assurance to the public that a high level of competence is maintained and that every practicable effort is being made to prevent substandard performance on the part of practitioners.

.02 Toward this end, the American Institute of Certified Public Accountants has established a voluntary program of review of quality control maintained by CPA firms in their audit practices. Standards of quality control have also been promulgated for use in conducting such reviews.

.03 The purpose of the program is educational and preventive in nature and is designed to assist firms in developing and implementing adequate systems of quality control in their audit practices as well as assuring firms with existing systems that their quality control meets, in all material respects, the standards of the profession.

.04 To fulfill its dual purpose, the program includes two types of reviews: consulting reviews and compliance reviews. Consulting reviews are intended to assist firms in developing their systems of quality control and in preparing for participation in the program. Compliance reviews are designed to establish that the quality controls of participating firms meet the standards of the profession.

.05 CPA firms that provide accounting services such as preparation of unaudited financial statements but do not conduct audits also participate in the program. Their participation is based on their procedures for complying with professional standards applicable to unaudited financial statements and on their systems of quality control for audit practice which would be placed in effect should they accept audit engagements.

.06 The program provides direct benefits to the participating firms through the application of objective, outside reviews to their quality control policies and procedures. It is reasonable to expect that these reviews will reduce the number of failures in audit performance that might otherwise occur. However, they cannot provide absolute assurance that all mistakes will be avoided. The basic elements of the program are described in the balance of this document.

## **Administration of Program**

.07 The quality control review program, including both consulting reviews and compliance reviews, is administered by a quality control review committee, which establishes policies for implementation of the program. The committee is also responsible for acquainting the business community and general public with the program and the significance of a CPA firm's participation.

.08 As experience is gained, the committee will modify the program to increase its effectiveness. However, the basic features of the plan can be modified only by Council.

.09 The committee is composed of AICPA members in public practice selected to provide a broad representation of the profession. A qualified staff works under the direction of the committee to assist in carrying out the program.

.10 Two subcommittees operate under the direction of the quality control review committee. One subcommittee is charged with administration of compliance reviews of firms with SEC practices. The other subcommittee administers the consulting reviews and compliance reviews for firms with general audit practices. Some members of the subcommittees are drawn from the quality control review committee.

.11 The possibility exists that a disagreement may arise between a firm and its reviewers. If this occurs and the firm is being reviewed by a review team, the dispute may be submitted to the appropriate subcommittee for resolution. If the firm is being reviewed by another firm, this procedure may be followed with the consent of both firms. If a dispute cannot be resolved by the subcommittee, it will be referred for resolution to an ad hoc review committee appointed by the chairman of the board of the AICPA.

## **Consulting Reviews**

### *General Description*

.12 It is expected that some firms will request assistance in organizing their quality control procedures. The following consultation or educational reviews are provided to assist firms in the conduct of their practices or in their preparation for participation in the quality control review program.

.13 The reviews are conducted on a confidential basis. Except for the quality control document review, no written reports are prepared by the review teams. Neither the Institute nor the reviewed firms will disclose that the reviews have taken place. The reviewed firms pay the reviewers' fees and travel expenses.

*Quality Control Document Review*

.14 The Institute provides a service whereby a firm preparing for participation may send a description of its quality control system to the Institute for review and comment. This service is not intended to be a regular prelude to a quality control review or to be an alternative for the preliminary quality control procedures review described below. Rather, it is a means for a firm to obtain advice on the adequacy of its quality control document. If more than a nominal amount of time is required for this service, the firm is charged a fee.

*Preliminary Quality Control Procedures Review*

.15 To assist those firms which might want to have others come to their offices to look at their documented procedures and comment on them, a preliminary quality control procedures review program is provided. As is the case with a quality control review, the reviewers make an objective analysis of the documented procedures in the light of the firm's size, organizational structure, and practice philosophies.

.16 The purpose of the preliminary review is to help a firm prepare for participation in the quality control review program by providing an objective evaluation of the adequacy of its procedures and, if necessary, suggestions for revisions. A review provides a measure of comfort to a firm before it files a letter of intent to participate in the program.

.17 These voluntary reviews are made in the firms' offices on a confidential basis. Since a preliminary review is informal and not complete, it is not a substitute for a full-fledged quality control review.

*Technical Standards Review*

.18 This program provides an in-house post-issuance review of working papers and reports for audit engagements and unaudited financial statement engagements. Through this program, firms can arrange for confidential objective reviews of their application of technical standards as indicated by their engagement working papers and reports.

.19 Checklists for these technical standards reviews which are updated annually may be purchased from the AICPA to assist firms in meeting professional requirements.

**General Description of Compliance Reviews**

.20 The quality control review program is voluntary and has the following features:

- (1) The program is open to CPA firms with SEC practices or which have a desire to prepare for such practice, to CPA firms with general audit practices, and to those CPA firms that provide accounting services such as preparation of unaudited financial statements.
- (2) A quality control review committee composed of members in public practice administers the program.
- (3) Participation in the program is initiated by a firm's filing a letter of intent with the Institute. The firm states in the letter that it will comply with the provisions of the program and that it will undergo a review of its documented quality control policies and procedures.
- (4) At the inauguration of the program, some months are needed for firms to arrange for their field reviews. Therefore, responses to inquiries regarding the status of participating firms are to be limited to the statement that they have filed a letter of intent, but that no information about completion of field reviews is to be released by the reviewed firms or the Institute until the end of this interim period.
- (5) Field reviews are conducted in accordance with standards approved by the auditing standards executive committee. A review is carried out by one of the following methods at the election of the firm to be reviewed:
  - a. A review team appointed by the committee.
  - b. A CPA firm engaged by the firm under review.
  - c. Some other form of independent review satisfactory to the committee, such as an acceptable plan administered by a state society of CPAs.
- (6) A review includes examination of audit working papers to the extent necessary to determine whether the firm's quality control policies are in compliance with professional standards. The depth of review of working papers for particular engagements is left to the judgment of the reviewers. The review is directed primarily to the key areas of an audit to determine whether in those areas there were well planned and appropriately executed auditing procedures that were documented in accordance with the firm's policies. If the firm has a significant number of engagements for unaudited financial statements, those engagements are also subject to review.

- (7) A firm electing to use a committee-appointed review team agrees to provide qualified personnel for the panel from which reviewers for the reviews of other firms are drawn.
- (8) Upon completion of the review, the review team or reviewing firm prepares a short report stating the results of the review. The report is submitted to the reviewed firm which, at its option, submits the report to the Institute. Such reviews are to be conducted at least once every three years for the firm to continue as a participant.
- (9) For administrative purposes, the Institute maintains a record of firms filing letters of intent and a record of firms submitting reports on the results of reviews. These records are available to the public upon request.
- (10) At its option, a firm may advise its clients of having filed a letter of intent and, subsequently, of the results of the review and that the report of the review is on file at the Institute. Results of reviews are not to be released until the end of an interim period to provide time for the completion of reviews of firms participating in the program at its outset.
- (11) To maintain the program on a self-supporting basis, the following fees are charged to firms:
  - a. An annual participation fee based on the number of the firm's professional personnel. A modest fee covers the administrative cost of the program.
  - b. Fees for reviews conducted by committee-appointed review teams. These fees are based on the per diem rates for the reviewers and their out-of-pocket expenses. Participating firms electing to be reviewed by other firms make their own fee arrangements.
- (12) The committee recognizes that there are differences in the size, structure, and clientele of CPA firms and that quality control procedures will vary according to those characteristics. This program is administered in such a way, however, as to provide a degree of confidence that the participating firms are adhering to applicable professional standards even though they may have varying policies and procedures to achieve such adherence.
- (13) The program is not intended as a means for taking disciplinary action since it is directed toward reviewing the systems of quality control of firms for their compliance with professional standards rather than the performance of individual professional staff members. It relies on the firms to maintain a continuing surveillance of the performance of their professional staff members.

However, in the event serious violations of technical standards are encountered as a by-product of the program and the reviewed firm does not take appropriate corrective action, the reviewers are not precluded from referring such information to the Institute's professional ethics division. Such reference would be discretionary and any decision in that regard would be made in light of the circumstances.

## **General Procedures for Compliance Reviews**

### *Letter of Intent*

.21 A firm advises the committee of its decision to participate in the program by filing a letter of intent with the following features:

- (1) Advice as to the method of review selected.
- (2) The date by which the firm's review will be started and the estimated completion date.
- (3) A statement that the firm has documented policies and procedures for the quality control of its audit practice.

.22 A firm may terminate its participation in the program at any time. Also, a firm's participation is terminated if it fails to submit a report on the results of its field review within the time period specified under the program and consistent with the standards of the program. After termination, the firm can no longer refer to itself as a participating firm although it may apply at any time to renew its participation.

### *Quality Control Policies and Procedures*

.23 A firm's quality control policies and procedures affect the quality of work in the firm's audit engagements. While aspects of quality control apply to all firms, the extent to which policies and procedures apply will depend on a variety of factors, such as the size, number of offices, and organizational structure of the firm, and its philosophy and practice as to the degree of operating autonomy appropriate for its people. A participating firm is required to make available to the review team or reviewing firm its policies and procedures for quality control.

[.24] [Superseded by section 200.]

.25 In developing its quality control policies and procedures, a firm must be guided by Statement on Quality Control Standards No. 1 [section 10], "*System of Quality Control for CPA Firm.*" This Statement discusses the elements of quality control as follows:

- a. *Independence.* Policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required

by the rules of conduct of the AICPA. Rule 101 [ET section 101.01] of the rules of conduct contains examples of instances wherein a firm's independence will be considered to be impaired.

- b. *Assigning Personnel to Engagements.* Policies and procedures for assigning personnel to engagements should be established to provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. In making assignments, the nature and extent of supervision to be provided should be taken into account. Generally, the more able and experienced the personnel assigned to a particular engagement, the less is the need for direct supervision.
- c. *Consultation.* Policies and procedures for consultation should be established to provide the firm with reasonable assurance that personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority. The nature of the arrangements for consultation will depend on a number of factors, including the size of the firm and the levels of knowledge, competence, and judgment possessed by the persons performing the work.
- d. *Supervision.* Policies and procedures for the conduct and supervision of work at all organizational levels should be established to provide the firm with reasonable assurance that the work performed meets the firm's standards of quality. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of the persons performing the work, and the extent of consultation available and used. The responsibility of a firm for establishing procedures for supervision is distinct from the responsibility of individuals to adequately plan and supervise the work on a particular engagement.
- e. *Hiring.* Policies and procedures for hiring should be established to provide the firm with reasonable assurance that those employed possess the appropriate characteristics to enable them to perform competently. The quality of a firm's work ultimately depends on the integrity, competence, and motivation of personnel who perform and supervise the work. Thus, a firm's recruiting programs are factors in maintaining such quality.
- f. *Professional Development.* Policies and procedures for professional development should be established to provide the firm with reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Continuing professional education and training activities enable a

firm to provide personnel with the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.

- g. Advancement.* Policies and procedures for advancing personnel should be established to provide the firm with reasonable assurance that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume. Practices in advancing personnel have important implications for the quality of a firm's work. Qualifications that personnel selected for advancement should possess include, but are not limited to, character, intelligence, judgment, and motivation.
- h. Acceptance and Continuance of Clients.* Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships.
- i. Inspection.* Policies and procedures for inspection should be established to provide the firm with reasonable assurance that the procedures relating to the other elements of quality control are being effectively applied. Procedures for inspection may be developed and performed by individuals acting on behalf of the firm's management. The type of inspection procedures used will depend on the controls established by the firm and the assignment of responsibilities within the firm to implement its quality control policies and procedures.

### *Field Reviews*

.26 Field reviews are designed to obtain assurance that a firm's quality control policies and procedures conform to professional standards, are adequately documented, and are being complied with. All participating firms are required to undergo a field review at least once every three years to retain their status as participants.

.27 Reviews are conducted at the mutual convenience of the reviewed firm and the reviewers. To accommodate the normal business cycle of the firms, the reviews are conducted during the months of April through December.

.28 Review team members and reviewing firms are expected to have a knowledge of the type of practice of the firm to be reviewed.



.29 It is the responsibility of the review team or reviewing firm to review the quality control policies and procedures to determine that they provide measures reasonable for the particular firm. The firm is advised of apparent deviations, if any, from specified standards. The reviewed firm is given an opportunity to refute or correct such apparent deviations before completion of the review and issuance of the report.

.30 The field reviews are designed, in part, to ascertain that the firm's internal system of quality control is operating as represented. To accomplish this objective, initial attention is directed to a review of documentation in the firm's administrative files, which in the case of multi-office firms is normally located at the executive office. For example, the executive office probably has statistics, correspondence, and other data relative to procedures regarding client acceptance and retention, hiring, training, promotion, independence, and inspection. In addition, the executive office probably has data useful in judging compliance with the firm's policies with respect to supervision and review and consultation.

.31 Client files relating to selected audit engagements, which are normally located in practice offices, are reviewed. The depth of the review of the working papers for particular engagements is decided by the reviewers. The review is directed primarily to the key areas of an audit to determine whether in those areas there were well planned and appropriately executed auditing procedures that were documented in accordance with the firm's policies.

.32 On occasion, an office of a firm may have legitimate reasons for not permitting the files for a selected engagement to be examined. For example, the financial statements of an engagement may be the subject of litigation or investigation by a government authority or the firm may have been advised by the client that it objects to exposure of the working papers to others, such as the review team. If those making the field review are not satisfied as to the legitimacy of the explanation, the matter is reported to the firm's managing partner.

.33 In the case of a multi-office firm, the degree of centralization of the firm's quality control affects the relative amount of time to be spent at the executive or practice offices. Practice offices visited are generally representative of the firm's overall audit practice.

.34 *Committee-Appointed Review Teams.* Review teams appointed by the committee are drawn from the panel of reviewers volunteered by the participating firms. Each team is headed by a team captain who organizes the review according to general guidelines prepared by the committee, supervises the reviewers, and prepares a report on the findings of the review. The firm to be reviewed is advised in advance of the names of the reviewers and their firms.

.35 Participating firms electing to undergo field tests conducted by committee-appointed review teams are required to nominate qualified personnel from their firms for the reviewer panel. Reviews of firms having SEC practices are conducted by audit partners and audit managers knowledgeable about current SEC practice. Reviews of firms with general audit practices are conducted by audit partners and other audit personnel experienced in general audit practice. Managers and other nonpartners are utilized only where subject to the supervision of a partner. A profile is submitted for each nominee indicating the extent of audit experience, SEC experience, participation in his firm's internal quality review programs, present responsibilities, and industry or other special expertise.

.36 The members of a review team are drawn from the reviewer panel. Normally only one partner from a firm is selected for a field test team. In selecting reviewers, consideration is given to their experience with firms and practice units of comparable size and types of practice. Reviewers are required to adhere to all standards applicable to professional engagements, including confidentiality of client relationships. Firms being reviewed by review teams are required to pay the per diem fees of the reviewers and their out-of-pocket travel expenses. The committee sets standard per diem fees for this purpose. The fees are not so large that they might become a reviewer's motive for participating in the program, but reasonably compensate the reviewers' firms for the services of their partners and managers. Reviewers receive fees considerably less than their standard professional fees for services rendered to clients. The team captain receives a slightly higher fee in view of his greater responsibility. These lower fees are justified on the grounds that the program is beneficial not only to the participating firms, but also to the accounting profession as a whole and to the individual reviewers who gain an educational experience from reviewing the procedures of other firms.

.37 The aggregate fee and out-of-pocket travel expenses are paid by the reviewed firm to the Institute for disbursement to the firms of the members of the review team.

.38 A reviewer is not assigned to the review of an executive or practice office in the same geographic area in which he is engaged in public practice. If only one individual is designated by the team captain to visit a practice office, he must be a partner. However, where more than one team member is involved in a visit to either an executive or practice office, the team members are from different firms and a partner is designated to be in charge of the inspection.

.39 For those reviews conducted by a committee-appointed review team, working papers are retained only until such time as the report on

the review has been filed with the Institute or the period for filing the report has elapsed, whichever is earlier.

**.40 CPA Firm-Conducted Field Reviews.** A participating firm may elect to have the field review of its procedures conducted by another CPA firm instead of by a committee-appointed review team. The reviewing firm follows applicable standards for the conduct of field reviews. In the cases of reviews of firms with SEC practices, the reviewing firm must be knowledgeable about current SEC practice.

**.41** The CPA firm conducting the review is independent of the reviewed firm. For example, reciprocal reviews by firms are not permitted.

**.42** As is the case with a committee-appointed review team, the reviewing firm is responsible for determining that the quality control policies and procedures provide measures reasonable for the particular firm and that they are being complied with.

#### *Reports on Field Reviews*

**.43** Upon completion of the field review, the review team or the reviewing firm reports on the results of the review to the reviewed firm and provides a written short-form report indicating whether or not the firm was complying with the profession's quality control standards.

**.44** The reviewed firm, at its option, submits the short-form report to the Institute to maintain the firm's participant status. A copy of the report is maintained in the files of the Institute and is available for public inspection.

**.45** Failure to file a report with the Institute within a three-year period causes a firm to be dropped as a participant. Termination of a firm's participation is not publicized.

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## Scope of the Quality Control Document Review\*

.01 The quality control document review is a service whereby a CPA firm may send a description of its quality control system (a quality control document) to the Institute for review and comment. This service is one of the consulting reviews provided under the Institute's voluntary quality control review program for CPA firms. The fee charged for this service is \$150 for an initial review of a firm's document. If a firm submits a revised version of its reviewed document, the fee charged will be \$35 per hour for the additional review.

.02 The review involves a comparison of the document to the policies and procedures presented in *A Guide to Implement the Voluntary Quality Control Review Program for CPA Firms—Quality Control Policies and Procedures for Participating CPA Firms* and is performed by staff of the Institute's quality control review division. The review does not involve a visit to a firm's offices. Accordingly, the review is limited to the description of the firm's accounting and auditing quality control policies and procedures as set forth in the document submitted to the Institute.

.03 This review does not constitute a quality control compliance review or a preliminary quality control procedures review pursuant to the program. In addition, the review is not intended to provide any assurance with regard to the manner in which the firm performs professional services, either in general, or with respect to any specific engagement.

.04 Written comments regarding the document will be offered for the firm's consideration subject to its professional judgment and evaluation in making use of them. Comments expressed by staff performing the review are not official opinions of the Institute or any of its committees. Such comments are the views of the individuals who offer them.

.05 The program stipulates that consulting reviews are conducted on a confidential basis. Accordingly, neither the Institute nor the reviewed firm will disclose that the review has taken place.

➡ The next page is 17,401. ←

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\* Issued by the Quality Control Standards Committee, February, 1978.

## NOTICE TO READERS

The Special Committee on Proposed Standards for Quality Control Policies and Procedures developed this section to provide guidance in the establishment of quality control policies and procedures by a CPA firm intending to participate in the Voluntary Quality Control Review Program for CPA Firms.

The special committee believes that this guide should be reviewed from time to time by the AICPA to determine whether the material requires modification, update, or amendment in the light of future developments in practice.

### Special Committee on Proposed Standards for Quality Control Policies and Procedures

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➡ The next page is 17,431. ⬅

**QC Section 200****Quality Control Policies and  
Procedures for Participating  
CPA Firms****Introduction**

.01 The purpose of this section is to provide guidance for establishment of quality control policies and procedures for CPA firms participating in the Voluntary Quality Control Review Program for CPA Firms (the "program"). This section is not intended to be applicable to CPA firms not participating in the program. As used in this section, the term *participating firm* encompasses those firms that are preparing for involvement in the program as well as participants. A firm is identified as a participant in the program only upon completion of its compliance review and filing with the Institute an acceptable report on that review. The program requires that "in developing its quality control policies and procedures, a firm must be guided by Statement on Quality Control Standards No. 1 [section 10], *System of Quality Control for a CPA Firm*." The elements of quality control are identified in Statement on Quality Control Standards No. 1 [section 10] and are discussed in this section under the following headings:

1. Independence
2. Assigning Personnel to Engagements
3. Consultation
4. Supervision
5. Hiring
6. Professional Development
7. Advancement
8. Acceptance and Continuance of Clients
9. Inspection

When a firm is participating in the program, the elements of quality control are applicable to segments of its practice wherein the firm is associated with financial statements, including unaudited financial statements. While the elements of quality control and related policies and procedures discussed in this guide may have some significance for other segments of a participating firm's practice, such as providing tax services or management advisory services, other than when associated with financial statements, their relationship to those other segments is not covered by this section.

.02 As used in this section, the term *policies* refers to a participating firm's objectives and goals for effecting the elements of quality control. *Procedures* refer to the steps to be taken to accomplish the policies adopted. Unless the text states otherwise, *personnel* encompasses all the professionals associated with the participating firm's accounting and auditing practice and includes partners, principals, and stockholders or officers of professional corporations.

.03 The purpose of a firm's considering the elements of quality control and adopting quality control policies and procedures is to provide reasonable assurance that it is conforming with generally accepted auditing standards. Participating firms should provide documentation or other evidential matter that will facilitate a subsequent compliance review. The concept of reasonable assurance recognizes that economic considerations affect the conduct of a firm's practice. Therefore, the extent to which quality control policies and procedures are adopted and placed in effect may be influenced by appropriate cost/benefit considerations.

.04 The underlying philosophy and organizational structure of a participating firm provide the framework for its quality control policies and procedures. The extent to which a participating firm should adopt these policies and procedures, and those which are appropriate for a particular firm, depend on a number of factors, such as its size, the degree of operating autonomy appropriately allowed to its people and its practice offices, the nature of its practice, and its administrative controls. Accordingly, it is expected that policies and procedures adopted, and documentation thereof, would normally be more extensive for a larger or multi-office firm than for a smaller or single-office firm.

.05 Each element of quality control is discussed in this guide in a separate section, consisting of an introduction and policies and procedures. It should be recognized, however, that the practice of a firm does not permit clear-cut distinctions among these elements, which ordinarily overlap and are interrelated.

.06 A participating firm should consider establishing policies in the areas identified by numbers under each element of quality control discussed herein to the extent such policies are applicable to its practice. Illustrative examples of procedures designed to implement the policies adopted are also presented. The specific procedures used by a participating firm would not necessarily include all those illustrated or be limited to them.

.07 Since a firm's policies and procedures may require modification in the light of changing conditions, they should be reviewed on a continuing basis and revised when necessary.

.08 Some regulatory agencies have promulgated requirements for compliance with independence or other standards that are applicable

to professionals practicing before them. Therefore, a firm should adopt policies and procedures to provide reasonable assurance of compliance with the requirements of regulatory agencies before which it practices.

.09 It is the responsibility of a U. S. firm to establish controls to assure that segments of its engagements performed outside the United States are performed in accordance with U.S. generally accepted auditing standards. While the elements of quality control are applicable to such international practice, local customs and conditions may result in variations in their application. However, it is not intended that the program require that the quality control policies and procedures of a U.S. firm be adopted by its international affiliates. The quality control objectives of a U.S. firm are met when its policies and procedures provide reasonable assurance that portions of its engagements performed outside the United States conform to U.S. standards.

.10 When firms merge or when a firm acquires a practice, the combined firm should give special attention to quality control considerations. The combined firm's quality control policies and procedures should be evaluated to determine that they continue to be applicable in light of the changed circumstances. The firm's quality control policies and procedures, revised to the extent necessary, should be monitored for effectiveness. Similar attention should be given to quality control considerations when a firm is divided.

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.11 On October 23, 1976, Council adopted the Voluntary Quality Control Review Program for CPA Firms. The program requires that a participating firm have documented quality control policies and procedures. A firm participating in the program agrees to undergo periodic compliance reviews to obtain assurance that its quality control policies and procedures conform to professional standards, are adequately documented, and are being complied with. In connection therewith, a participating firm may meet the requirement for documented quality control policies and procedures by preparing either of the following:

1. A quality control document that provides a detailed description of its quality control policies and procedures.
2. A summary statement of its quality control policies and procedures with references to supporting information contained in manuals, memoranda, or other technical literature of the firm.

A quality control document, in addition to discussing the participating firm's quality control policies and procedures, may also contain



a description of the firm's organization (including an organization chart), its philosophy of practice, and other descriptive material relating to the firm's operations and the nine elements of quality control.

## Independence

.12 The second general standard of generally accepted auditing standards indicates that "in all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors." The *Code of Professional Ethics* of the American Institute of CPAs<sup>1</sup> states that "The public expects a number of character traits in a certified public accountant, but primarily integrity and objectivity and, in the practice of public accounting, independence. . . . Independence has traditionally been defined by the profession as the ability to act with integrity and objectivity."

.13 A participating firm should establish policies and procedures for maintaining independence to provide reasonable assurance that personnel<sup>2</sup> at all organizational levels maintain independence in fact and in appearance where such independence is required by applicable professional standards.<sup>3</sup>

### *Policies and Procedures*

.14 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a

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<sup>1</sup> Some regulatory agencies, including the Securities and Exchange Commission and the United States General Accounting Office, have promulgated rules or regulations regarding independence of accountants practicing before them. Rule 2-01 of the Commission's Regulation S-X, "Qualifications of Accountants," addresses itself in part to the subject of independence: "The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent." Paragraphs (b) and (c) of this rule provide guidance as to its application. Further guidance and examples of situations involving independence are provided by the commission in accounting series releases. The General Accounting Office publication, *Standards for Audit of Governmental Organizations, Programs, Activities & Functions*, treats the subject of independence in chapter 3.

<sup>2</sup> For the purposes of this section on independence, the term *personnel* encompasses all professional persons of the participating firm and is not limited to those in the accounting and auditing practice area.

<sup>3</sup> In instances where a firm is associated with financial statements, and the firm is not independent, see Statement on Auditing Standards No. 26 [AU section 504], for reporting requirements.

firm would not necessarily include all the examples or be limited to those illustrated.

- 1. Require that personnel at all organizational levels adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, state CPA society, state board of accountancy, state statute, and, if applicable, the Securities and Exchange Commission and other regulatory agencies.<sup>4</sup>**
  - a. Designate an individual or group to provide guidance and to resolve questions on independence matters.**
    - (i) Identify circumstances where documentation as to the resolution of questions would be appropriate.**
    - (ii) Require consultation with authoritative sources when considered necessary.**
- 2. Communicate policies and procedures relating to independence to personnel at all organizational levels.**
  - a. Inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with these policies and procedures.**
  - b. Emphasize independence of mental attitude in training programs and in supervision and review of engagements.**
  - c. Apprise personnel on a timely basis of those entities to which independence policies apply.**
    - (i) Prepare and maintain for independence purposes a list of the firm's clients and of other entities (client's affiliates, parents, associates, and so forth) to which independence policies apply.**
    - (ii) Make the list available to personnel (including personnel new to the firm or to an office) who need it to determine their independence.**
    - (iii) Establish procedures to notify personnel of changes in the list.**
  - d. Maintain a library or other facility containing professional, regulatory, and firm literature relating to independence matters.**

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<sup>4</sup> In some cases, a firm may wish to establish other requirements that it deems appropriate, for example, concerning prohibited transactions or relationships.

3. Confirm, when acting as principal auditor, the independence of another firm engaged to perform segments of an engagement.<sup>3</sup>
  - a. Inform personnel as to the form and content of an independence representation that is to be obtained from a firm that has been engaged to perform segments of an engagement.
  - b. Advise personnel as to the frequency with which a representation should be obtained from an affiliate or associate firm for a repeat engagement.
4. Monitor compliance with policies and procedures relating to independence.
  - a. Obtain from personnel periodic, written representations, normally on an annual basis, stating that—
    - (i) They are familiar with the firm's independence policies and procedures.
    - (ii) Prohibited investments are not held and were not held during the period. As an alternative or additional procedure, a firm may obtain listings of investments and securities transactions (numbers of shares or dollar amounts need not be included) from personnel to determine that there are no prohibited holdings.
    - (iii) Prohibited relationships do not exist, and transactions prohibited by firm policy have not occurred.
  - b. Assign responsibility for resolving exceptions to a person or group with appropriate authority.
  - c. Assign responsibility for obtaining representations and reviewing independence compliance files for completeness to a person or group with appropriate authority.
  - d. Review periodically accounts receivable from clients to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

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<sup>3</sup> If a firm utilizes the services of a related, affiliated, or associated firm, the principal firm may obtain periodically (frequently annually) a representation from the other firm covering all referred engagements, or may include the representation as part of a continuing agreement.

If a firm other than an affiliate or associate is retained, representation should be received for each engagement.

In the case of an international engagement, the representation from the foreign firm should make reference to U. S. independence standards.

## Assigning Personnel to Engagements

.15 Guidance in assigning personnel is found in the first general standard of generally accepted auditing standards which states that "the examination is to be performed by a person or persons having adequate technical training and proficiency as an auditor." A participating firm should establish policies and procedures for assigning personnel to engagements to provide reasonable assurance that engagements will be performed by persons having the degree of technical training and proficiency required in the circumstances.

### *Policies and Procedures*

.16 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Delineate the firm's approach to assigning personnel, including the planning of overall firm and office needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.
  - a. Plan the personnel needs of the firm on an overall basis and for individual practice offices.
  - b. Identify on a timely basis the staffing requirements of specific engagements.
  - c. Prepare time budgets for engagements to determine manpower requirements and to schedule field work.
  - d. Consider the following factors in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:
    - (i) Engagement size and complexity.
    - (ii) Personnel availability.
    - (iii) Special expertise required.
    - (iv) Timing of the work to be performed.
    - (v) Continuity and periodic rotation of personnel.
    - (vi) Opportunities for on-the-job training.
2. Designate an appropriate person or persons to be responsible for assigning personnel to engagements.
  - a. Consider the following in making assignments of individuals:
    - (i) Staffing and timing requirements of the specific engagement.

- (ii) Evaluations of the qualifications of personnel as to experience, position, background, and special expertise.
  - (iii) The planned supervision and involvement by supervisory personnel.
  - (iv) Projected time availability of individuals assigned.
  - (v) Situations where possible independence problems and conflicts of interest may exist, such as assignment of personnel to engagements for clients who are former employers or are employers of certain kin.
- b. Give appropriate consideration, in assigning personnel, to both continuity and rotation to provide for efficient conduct of the engagement and the perspective of other personnel with different experience and backgrounds.
3. Provide for approval of the scheduling and staffing of the engagement by the person with final responsibility for the engagement.
- a. Submit, where necessary, for review and approval the names and qualifications of personnel to be assigned to an engagement.
  - b. Consider the experience and training of the engagement personnel in relation to the complexity or other requirements of the engagement, and the extent of supervision to be provided.

## **Consultation**

.17 A participating firm should establish policies and procedures for consultation to provide reasonable assurance that personnel will seek assistance on accounting and auditing questions, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority.

### ***Policies and Procedures***

.18 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Identify areas and specialized situations where consultation is required and encourage personnel to consult with or use authoritative sources on other complex or unusual matters.

- a. Inform personnel of the firm's consultation policies and procedures.
  - b. Specify areas or specialized situations requiring consultation because of the nature or complexity of the subject matter. Examples include—
    - (i) Application of newly issued technical pronouncements.
    - (ii) Industries with special accounting, auditing, or reporting requirements.
    - (iii) Emerging practice problems.
    - (iv) Choices among alternative generally accepted accounting principles when an accounting change is to be made.
    - (v) Filing requirements of regulatory agencies.
  - c. Maintain or provide access to adequate reference libraries and other authoritative sources.
    - (i) Establish responsibility for maintaining a reference library in each practice office.
    - (ii) Maintain technical manuals and issue technical pronouncements, including those relating to particular industries and other specialties.
    - (iii) Maintain consultation arrangements with other firms and individuals where necessary to supplement firm resources.
    - (iv) Refer problems to a division or group in the AICPA or state CPA society established to deal with technical inquiries.
  - d. Maintain a research function to assist personnel with practice problems.
- 2. Designate individuals as specialists to serve as authoritative sources and define their authority in consultative situations. Provide procedures for resolving differences of opinion between engagement personnel and specialists.**
- a. Designate individuals as specialists for filings with the Securities and Exchange Commission and other regulatory agencies.
  - b. Designate specialists for particular industries.
  - c. Advise personnel of the degree of authority to be accorded specialists' opinions and of the procedures to be followed for resolving differences of opinion with specialists.
  - d. Require documentation as to the considerations involved in the resolution of differences of opinion.
- 3. Specify the extent of documentation to be provided for the results of consultation in those areas and specialized situations where consultation is required. Specify documentation, as appropriate, for other consultations.**

- a. Advise personnel as to the extent of documentation to be prepared and the responsibility for its preparation.
- b. Indicate where consultation documentation is to be maintained.
- c. Maintain subject files containing the results of consultations for reference and research purposes.

## **Supervision**

.19 The first standard of field work of generally accepted auditing standards states that the work is to be adequately planned and assistants, if any, are to be properly supervised. A participating firm should establish policies and procedures for the conduct and supervision of work at all organizational levels to provide reasonable assurance that the work performed meets the firm's standards of quality.

.20 Procedures for supervision are necessary to provide reasonable assurance that appropriate judgments and conclusions can be drawn with respect to the work performed. The extent of supervision and review appropriate in a given instance depends on many factors, including the complexity of the subject matter, the qualifications of persons performing the work, and the extent of consultation available and used. Additional factors bearing upon the appropriate extent of supervision and review include the degree of authority delegated to assistants on an engagement, performance of personnel assigned to an engagement, and risk factors inherent in the engagement.

### ***Policies and Procedures***

.21 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

#### **1. Provide procedures for planning engagements.**

- a. Assign responsibility for planning an engagement. Involve appropriate personnel assigned to the engagement in the planning process.
- b. Develop background information or review information obtained from prior engagements and update for changed circumstances.

- c. Describe matters to be included in the engagement planning process, such as the following:
  - (i) Development of proposed work programs.
  - (ii) Determination of manpower requirements and need for specialized knowledge.
  - (iii) Development of estimates of time required to complete the engagement.
  - (iv) Consideration of current economic conditions affecting the client or its industry and their potential impact on the conduct of the engagement.
- 2. **Provide procedures for maintaining the firm's standards of quality for the work performed.**
  - a. Provide adequate supervision at all organizational levels, considering the training, ability, and experience of the personnel assigned.
  - b. Develop guidelines for the form and content of working papers.
  - c. Utilize standardized forms, checklists, and questionnaires to the extent appropriate to assist in the performance of engagements.
  - d. Provide procedures for resolving differences of professional judgment among members of an engagement team.
- 3. **Provide procedures for reviewing engagement working papers and reports.**
  - a. Develop guidelines for review of working papers and for documentation of the review process.
    - (i) Require that reviewers have appropriate competence and responsibility.
    - (ii) Determine that work performed is complete and conforms to professional standards and firm policy.
    - (iii) Describe documentation evidencing review of working papers and the reviewer's findings. Documentation may include initialing working papers, completing a reviewer's questionnaire, preparing a reviewer's memorandum, and employing standard forms or checklists.
  - b. Develop guidelines for review of the report to be issued for an engagement. Considerations in "a" above would be applicable to this review. In addition, the following matters should be considered for these guidelines:
    - (i) Determine that the evidence of work performed and conclusions contained in the working papers support the report.
    - (ii) Determine that the report conforms to professional standards and firm policy.



- (iii) Provide for review of the report by an appropriate individual having no other responsibility for the engagement.

## Hiring

.22 A firm's personnel may well be its most valuable asset. Although the hiring of personnel may be considered partly an administrative function, a firm's policies and procedures with respect to hiring affect the quality of its work. A participating firm should establish policies and procedures for hiring to provide reasonable assurance that those persons employed possess the appropriate characteristics to enable them to perform competently.

### *Policies and Procedures*

.23 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Maintain a program designed to obtain qualified personnel by planning for personnel needs, establishing hiring objectives, and setting qualifications for those involved in the hiring function.
  - a. Plan for the firm's personnel needs at all levels and establish quantified hiring objectives based on current clientele, anticipated growth, personnel turnover, individual advancement, and retirement.
  - b. Design a program to achieve hiring objectives which provides for—
    - (i) Identification of sources of potential hirees.
    - (ii) Methods of contact with potential hirees.
    - (iii) Methods of specific identification of potential hirees.
    - (iv) Methods of attracting potential hirees and informing them about the firm.
    - (v) Methods of evaluating and selecting potential hirees for extension of employment offers.
  - c. Inform those persons involved in hiring as to the firm's personnel needs and hiring objectives.
  - d. Assign to authorized persons the responsibility for employment decisions.

- e. Monitor the effectiveness of the recruiting program.
  - (i) Evaluate the recruiting program periodically to determine whether policies and procedures for obtaining qualified personnel are being observed.
  - (ii) Review hiring results periodically to determine whether goals and personnel needs are being achieved.
- 2. Establish qualifications and guidelines for evaluating potential hirees at each professional level.
  - a. Identify the attributes to be sought in hirees, such as intelligence, integrity, honesty, motivation, and aptitude for the profession.
  - b. Identify achievements and experiences desirable for entry-level and experienced personnel. For example,
    - (i) Academic background.
    - (ii) Personal achievements.
    - (iii) Work experience.
    - (iv) Personal interests.
  - c. Set guidelines to be followed when hiring individuals in atypical situations such as—
    - (i) Hiring relatives of personnel or relatives of clients.
    - (ii) Rehiring former employees.
    - (iii) Hiring client employees.
  - d. Obtain background information and documentation of qualifications of applicants by appropriate means, such as—
    - (i) Resumes.
    - (ii) Application forms.
    - (iii) Interviews.
    - (iv) College transcripts.
    - (v) Personal references.
    - (vi) Former employment references.
  - e. Evaluate the qualifications of new personnel, including those obtained from other than the usual hiring channels (for example, those joining the firm at supervisory levels or through merger or acquisition), to determine that they meet the firm's requirements and standards.
- 3. Inform applicants and new personnel of the firm's policies and procedures relevant to them.
  - a. Use a brochure or another means to so inform applicants and new personnel.
  - b. Prepare and maintain a manual describing policies and procedures for distribution to personnel.
  - c. Conduct an orientation program for new personnel.

## Professional Development

.24 The concept of professional development embodies recognition of the continuing obligation of personnel to maintain their competence during their professional careers. A participating firm should establish policies and procedures for professional development to provide reasonable assurance that personnel will have the knowledge required to enable them to fulfill responsibilities assigned. Professional development activities enable a firm to provide personnel with the means to acquire the knowledge required to fulfill responsibilities assigned to them and to progress within the firm.

### *Policies and Procedures*

.25 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Establish guidelines and requirements for the firm's professional development program and communicate them to personnel.
  - a. Assign responsibility for the professional development function to a person or group with appropriate authority.
  - b. Provide that programs developed by the firm be reviewed by qualified individuals. Programs should contain statements of objectives and education and/or experience prerequisites.
  - c. Provide an orientation program relating to the firm and the profession for newly employed personnel.
    - (i) Prepare publications and programs designed to inform newly employed personnel of their professional responsibilities and opportunities.
    - (ii) Designate responsibility for conducting orientation conferences to explain professional responsibilities and firm policies.
    - (iii) Enable newly employed personnel with limited experience to attend the AICPA or other comparable level staff training programs.
  - d. Establish continuing professional education requirements for personnel at each level within the firm.
    - (i) Consider state mandatory requirements or voluntary guidelines in establishing firm requirements.
    - (ii) Encourage participation in external continuing profes-

- sional education programs, including college-level and self-study courses.
- (iii) Encourage membership in professional organizations. Consider having the firm pay or contribute toward membership dues and expenses.
  - (iv) Encourage personnel to serve on professional committees, prepare articles, and participate in other professional activities.
- e. Monitor continuing professional education programs and maintain appropriate records, both on a firm and an individual basis.
- (i) Review periodically the records of participation by personnel to determine compliance with firm requirements.
  - (ii) Review periodically evaluation reports and other records prepared for continuing education programs to evaluate whether the programs are being presented effectively and are accomplishing firm objectives. Consider the need for new programs and for revision or elimination of ineffective programs.
2. Make available to personnel information about current developments in professional technical standards and materials containing the firm's technical policies and procedures and encourage personnel to engage in self-development activities.
- a. Provide personnel with professional literature relating to current developments in professional technical standards.
    - (i) Distribute to personnel material of general interest, such as pronouncements of the Financial Accounting Standards Board and the AICPA Auditing Standards Executive Committee.
    - (ii) Distribute pronouncements in areas of specific interest, such as those issued by the Securities and Exchange Commission, Internal Revenue Service, and other regulatory agencies to persons who have responsibility in such areas.
    - (iii) Distribute manuals containing firm policies and procedures on technical matters to personnel. Manuals should be updated for new developments and changing conditions.
  - b. For training programs presented by the firm, develop or obtain course materials and select and train instructors.
    - (i) State the program objectives and education and/or experience prerequisites in the training programs.
    - (ii) Provide that program instructors be qualified as to both program content and teaching methods.
    - (iii) Have participants evaluate program content and instructors of training sessions.

- (iv) Have instructors evaluate program content and participants in training sessions.
  - (v) Update programs as needed in light of new developments, changing conditions, and evaluation reports.
3. Provide, to the extent necessary, programs to fill the firm's needs for personnel with expertise in specialized areas and industries.
- a. Conduct firm programs to develop and maintain expertise in specialized areas and industries, such as regulated industries, computer auditing, and statistical sampling methods.
  - b. Encourage attendance at external education programs, meetings, and conferences to acquire technical or industry expertise.
  - c. Encourage membership and participation in organizations concerned with specialized areas and industries.
  - d. Provide technical literature relating to specialized areas and industries.
4. Provide for on-the-job training during the performance of engagements.
- a. Emphasize the importance of on-the-job training as a significant part of an individual's development.
    - (i) Discuss with assistants the relationship of the work they are performing to the engagement as a whole.
    - (ii) Involve assistants in as many portions of the engagement as practicable.
  - b. Emphasize the significance of personnel management skills and include coverage of these subjects in firm training programs.
  - c. Encourage personnel to train and develop subordinates.
  - d. Monitor assignments to determine that personnel—
    - (i) Fulfill, where applicable, the experience requirements of the state board of accountancy.
    - (ii) Gain experience in various areas of engagements and varied industries.
    - (iii) Work under different supervisory personnel.

## Advancement

.26 Advancement is the progression of personnel to positions of greater responsibility within a firm. A participating firm should establish policies and procedures to provide reasonable assurance that person-

nel selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called upon to assume.

### ***Policies and Procedures***

.27 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Establish qualifications deemed necessary for the various levels of responsibility within the firm.
  - a. Prepare guidelines describing responsibilities at each level and expected performance and qualifications necessary for advancement to each level, including—
    - (i) Titles and related responsibilities.
    - (ii) The amount of experience (which may be expressed as a time period) generally required for advancement to the succeeding level.
  - b. Identify criteria which will be considered in evaluating individual performance and expected proficiency, such as—
    - (i) Technical knowledge.
    - (ii) Analytical and judgmental abilities.
    - (iii) Communicative skills.
    - (iv) Leadership and training skills.
    - (v) Client relations.
    - (vi) Personal attitude and professional bearing (character, intelligence, judgment, and motivation).
    - (vii) Possession of a CPA certificate for advancement to a supervisory position.
  - c. Use a personnel manual or other means to communicate advancement policies and procedures to personnel.
2. Evaluate performance of personnel and periodically advise personnel of their progress. Maintain personnel files containing documentation relating to the evaluation process.
  - a. Gather and evaluate information on performance of personnel.
    - (i) Identify evaluation responsibilities and requirements at each level indicating who will prepare evaluations and when they will be prepared.
    - (ii) Instruct personnel on the objectives of personnel evaluation.

- (iii) Utilize forms, which may be standardized, for evaluating performance of personnel.
  - (iv) Review evaluations with the individual being evaluated.
  - (v) Require that evaluations be reviewed by the evaluator's superior.
  - (vi) Review evaluations to determine that individuals worked for and were evaluated by different persons.
  - (vii) Determine that evaluations are completed on a timely basis.
- b. Periodically counsel personnel as to their progress and career opportunities.
- (i) Review periodically with personnel the evaluation of their performance, including an assessment of their progress with the firm. Considerations should include the following:
    - (a) Performance.
    - (b) Future objectives of the firm and the individual.
    - (c) Assignment preferences.
    - (d) Career opportunities.
  - (ii) Evaluate partners periodically by means of counseling, peer evaluation, or self appraisal, as appropriate, as to whether they continue to have the qualifications to fulfill their responsibilities.
  - (iii) Review periodically the system of personnel evaluation and counseling to ascertain that—
    - (a) Procedures for evaluation and documentation are being followed on a timely basis.
    - (b) Requirements established for advancement are being achieved.
    - (c) Personnel decisions are consistent with evaluations.
    - (d) Recognition is given to outstanding performance.
3. Assign responsibility for making advancement decisions.
- a. Assign responsibility to designated persons for making advancement and termination decisions, conducting evaluation interviews with persons considered for advancement, documenting the results of the interviews, and maintaining appropriate records.
  - b. Evaluate data obtained giving appropriate recognition in advancement decisions to the quality of the work performed.
  - c. Study the firm's advancement experience periodically to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility.

## Acceptance and Continuance of Clients

.28 A participating firm should establish policies and procedures for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management lacks integrity. The firm does not vouch for the integrity or reliability of a client, nor does it have a duty to anyone but itself with respect to the acceptance, rejection, or retention of clients. However, the firm should consider that the reputation of a client's management could reflect on the reliability of representations and accounting records and on the firm's own reputation. In making decisions to accept or continue a client, a firm should also consider its own independence and its ability to service a client properly with particular reference to industry expertise, size of engagement, and manpower available to staff the engagement.

### *Policies and Procedures*

.29 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Establish procedures for evaluation of prospective clients and for their approval as clients.
  - a. Consider evaluation procedures such as the following before accepting a client:
    - (i) Obtain and review available financial information regarding the prospective client, such as annual reports, interim financial statements, registration statements, Forms 10-K, other reports to regulatory agencies, and income tax returns.
    - (ii) Inquire of third parties as to any information regarding the prospective client and its management and principals which may have a bearing on evaluating the prospective client. Inquiries may be directed to the prospective client's bankers, legal counsel, investment banker, underwriter, and others in the financial or business community who may have such knowledge. Credit reports may also be useful.
    - (iii) Communicate with the predecessor auditor as required by auditing standards. Inquiries should include questions regarding facts that might bear on the integrity of man-



- agement, on disagreements with management as to accounting principles, auditing procedures, or other similarly significant matters, and on the predecessor's understanding as to the reasons for the change of auditors.
- (iv) Consider circumstances which would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks.
  - (v) Evaluate the firm's independence and ability to service the prospective client. In evaluating the firm's ability, consider needs for technical skills, knowledge of the industry, and personnel.
  - (vi) Determine that acceptance of the client would not violate applicable regulatory agency requirements and the codes of professional ethics of the AICPA or a state CPA society.
- b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained regarding the prospective client and to make the acceptance decision.
    - (i) Consider types of engagements that the firm would not accept or which would be accepted only under certain conditions.
    - (ii) Provide for documentation of the conclusion reached.
  - c. Inform appropriate personnel of the firm's policies and procedures for accepting clients.
  - d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for acceptance of clients.
2. Evaluate clients at the end of specific periods or upon the occurrence of specified events to determine whether the relationships should be continued.
- a. Specify conditions which require evaluation of a client to determine whether the relationship should be continued. Conditions could include—
    - (i) The expiration of a time period.
    - (ii) A significant change since the last evaluation, including a major change in one or more of the following:
      - (a) Management.
      - (b) Directors.
      - (c) Ownership.
      - (d) Legal counsel.
      - (e) Financial condition.
      - (f) Litigation status.
      - (g) Nature of the client's business.
      - (h) Scope of the engagement.

- (iii) The existence of conditions which would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.
- b. Designate an individual or group, at appropriate management levels, to evaluate the information obtained and to make continuance decisions.
  - (i) Consider types of engagements that the firm would not continue or which would be continued only under certain conditions.
  - (ii) Provide for documentation of the conclusion reached.
- c. Inform appropriate personnel of the firm's policies and procedures for continuing clients.
- d. Designate responsibility for administering and monitoring compliance with the firm's policies and procedures for continuance of clients.

## Inspection

.30 A participating firm should establish policies and procedures for inspection to provide reasonable assurance that the other procedures designed to maintain the quality of the firm's accounting and auditing practice are being effectively applied. A firm's inspection policies and procedures should be related to the nature and extent of controls and monitoring procedures established for the other elements of quality control. While the inspection function is normally performed by the firm's personnel, procedures for inspection may be developed and performed by persons other than the firm's personnel acting on behalf of the firm's management.

### *Policies and Procedures*

.31 Consideration should be given by a firm to establishing policies to accomplish the objectives numbered below to the extent such objectives are applicable to its practice. Examples of procedures (which are identified by letters) designed to implement policies follow each objective, although the specific procedures adopted by a firm would not necessarily include all the examples or be limited to those illustrated.

1. Define the scope and content of the firm's inspection program.
  - a. Determine the inspection procedures necessary to provide reasonable assurance that the firm's other quality control policies and procedures are operating effectively.
    - (i) Determine objectives and prepare instructions and review programs for use in conducting inspection activities.

- (ii) Provide guidelines for the extent of work at practice units, functions, or departments, and criteria for selection of engagements for review.
    - (iii) Establish the frequency and timing of inspection activities.
    - (iv) Establish procedures to resolve disagreements which may arise between reviewers and engagement or management personnel.
  - b. Establish qualifications for personnel to participate in inspection activities and the method of their selection.
    - (i) Determine criteria for selecting reviewers, including levels of responsibility in the firm and requirements for specialized knowledge.
    - (ii) Assign responsibility for selecting inspection personnel.
  - c. Conduct inspection activities at practice units, functions, or departments.
    - (i) Review and test compliance with applicable quality control policies and procedures.
    - (ii) Review selected engagements for compliance with professional standards, including generally accepted auditing standards, generally accepted accounting principles, and with the firm's quality control policies and procedures.
2. Provide for reporting inspection findings to the appropriate management levels and for monitoring actions taken or planned.
- a. Discuss inspection review findings on engagements reviewed with engagement management personnel.
  - b. Discuss inspection findings of practice units, functions, or departments reviewed with appropriate management personnel.
  - c. Report inspection findings and recommendations to firm management together with corrective actions taken or planned.
  - d. Determine that planned corrective actions were taken.
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➡ *The next page is 17,483.* ←

## NOTICE TO READERS

The Special Committee on Proposed Standards for Quality Control Policies and Procedures developed this section to provide guidance for performing and reporting on quality control compliance reviews under the Voluntary Quality Control Review Program for CPA Firms.

This guide is the second issued by the special committee in implementing the Voluntary Review Program. The first, entitled *Quality Control Policies and Procedures for Participating CPA Firms*, provides guidance in the establishment of quality control policies and procedures by a CPA firm intending to participate in the Voluntary Review Program.

A CPA firm intending to participate in the Voluntary Review Program should consider the objectives of the compliance review as stated in the guide and the nature and extent of procedures that would be performed by a review team conducting a compliance review. The guide also provides guidance on reporting considerations and contains a model form of report acceptable for participation in the Voluntary Review Program.

The special committee believes that this guide should be reviewed from time to time by the AICPA to determine whether the material requires modification, update, or amendment in the light of future developments in practice.

### Special Committee on Proposed Standards for Quality Control Policies and Procedures

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➡ The next page is 17,513. ⬅

**QC Section 300****Performing and Reporting on  
Quality Control Compliance  
Reviews****Introduction**

.01 The purpose of this guide is to provide guidance for performing and reporting on quality control compliance reviews in connection with the AICPA Voluntary Quality Control Review Program for CPA Firms (the "program").<sup>1</sup> It should be read in conjunction with other guidance material issued to implement the program.

.02 In order to participate in the program, a CPA firm must undergo a quality control compliance review performed in accordance with the guidelines set forth herein and file an acceptable report (as discussed elsewhere herein) thereon with the AICPA. To continue as a participant, a CPA firm must undergo a compliance review at least once every three years and file an acceptable report thereon with the AICPA.

.03 The purpose of a firm's considering the elements of quality control and adopting quality control policies and procedures for its accounting and auditing practice is to provide the firm with reasonable assurance of conforming with standards of the profession in the conduct of its accounting and auditing practice.<sup>2</sup> For participating firms, an additional purpose is to provide documentation or other evidential matter that will facilitate a subsequent compliance review.<sup>3</sup>

.04 The quality control policies and procedures adopted by a participating firm will depend in part upon the firm's organizational structure, including factors such as its size, the degree of operating autonomy appropriately allowed to its personnel and its practice offices, the nature of its practice, and its administrative controls.

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<sup>1</sup> The terms *compliance reviews* and *field reviews*, as they are used in the program are synonymous and are used interchangeably in this section.

<sup>2</sup> Accounting and auditing practice, as referred to in this section, encompasses all accounting and auditing services for which standards have been established for the profession including accounting services resulting in association of the firm's name with unaudited financial statements.

<sup>3</sup> As used in this section, the term *participating firm* encompasses participants as well as those firms that are preparing for involvement in the program. A firm is identified as a participant in the program only upon completion of its compliance review and filing with the Institute an acceptable report on that review.

.05 A participating firm is required to make available to the review team the documented quality control policies and procedures incorporated in its quality control system.<sup>4</sup> This requirement is met by furnishing one of the following to the review team:

1. A quality control document that provides a detailed description of the firm's quality control policies and procedures.
2. A summary statement of the firm's quality control policies and procedures with references to supporting information contained in manuals, memorandums, or other literature of the firm.

A quality control document or summary, in addition to discussing the firm's quality control policies and procedures, may also contain a description of the firm's organization (including an organization chart), a discussion of its philosophy of practice, and other descriptive material relating to the elements of quality control and the firm's operations.

.06 The guidance included herein is applicable to reviewing entities ("review teams") and to individual reviewers ("review team members") who perform or are involved in performing quality control compliance reviews and who report on such reviews under the program.

## **Performing Quality Control Compliance Reviews**

### ***Objectives of the Compliance Review***

.07 Compliance reviews are intended to evaluate whether a reviewed firm's system of quality control for its accounting and auditing practice is appropriately comprehensive and suitably designed for the reviewed firm and whether its quality control policies and procedures are adequately documented, communicated to professional personnel, and are being complied with to provide the firm with reasonable assurance of conforming with the standards of the pro-

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<sup>4</sup> The system of quality control maintained by a CPA firm encompasses the firm's organizational structure and the policies adopted and procedures established to provide the firm with reasonable assurance of conforming with the standards of the profession in the conduct of the firm's accounting and auditing practice.

fession for firms that are participating in the program.<sup>5</sup>

.08 It is intended that this evaluation be accomplished by—

1. Study and evaluation of a reviewed firm's quality control system.
2. Review for compliance with a reviewed firm's quality control policies and procedures by—
  - Review at each organizational or functional level within the firm.
  - Review of selected engagement working paper files and reports.

.09 Upon completion of a compliance review, the review team communicates its findings to the reviewed firm and prepares a written report in accordance with the guidelines for reporting on quality control compliance reviews.

### ***General Considerations***

.10 *Confidentiality.* The compliance review is to be conducted with due regard for requirements of confidentiality of the rules of conduct of the code of professional ethics of the AICPA. Information obtained as a consequence of the review concerning the reviewed firm or any of its clients is confidential and should not be disclosed by review team members to anyone not associated with the review.

It is the responsibility of the reviewed firm to take such measures, if any, as may be necessary to satisfy its obligations concerning client confidentiality. Rule 301 of the AICPA's code of professional ethics contains an exception to the confidentiality requirements so that review of a member's professional practices as part of a voluntary quality review under AICPA authorization is not prohibited. Some state statutes or ethics rules promulgated by state boards of accountancy may, however, not clearly provide a similar exception regarding client confidentiality.<sup>6</sup> Accordingly, a reviewed firm may wish to

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<sup>5</sup> As used in this context, *documentation* refers both to the reviewed firm's documented quality control policies and procedures as well as to supporting materials presented to the review team as evidence of compliance with those policies and procedures.

As used in this section, *compliance* means adherence to prescribed policies or procedures in the substantial majority of situations; it does not imply adherence to prescribed policies or procedures in every case.

<sup>6</sup> The AICPA maintains a current listing of states that do not clearly provide an exception to the confidentiality requirements discussed in this section. Such information may be obtained upon request.

consult its legal counsel to determine whether any action is required to permit client engagement files to be made available to the review team.

.11 *Independence.* Independence with respect to the reviewed firm must be maintained by the reviewing firm by review team members, and by their consultants. The AICPA's code of professional ethics does not specifically consider relationships between reviewers, reviewed firms, and clients of reviewed firms. However, the concepts pertaining to independence embodied in the code should be considered for their application.

Reciprocal reviews are not permitted. This prohibition is applicable to a reviewing firm and, for a review conducted by a committee-appointed review team, to the firm with which the review team captain or members of an executive or supervisory committee are associated.

Reviewing firms should consider any family or other relationships between the firms' senior managements at organizational and functional levels in assessing the possibility of an impairment of independence.

Some firms perform engagement correspondent work for other firms. The correspondent firms' fee may be paid by the referring firm or directly by the client. In either situation, if the fees for the correspondent work are material to either the reviewed firm or reviewing firm, independence for purposes of the program is impaired.

Some reviewers or their firms may have continuing arrangements with other firms whereby fees, office facilities, or professional staff are shared. In these situations, independence for purposes of the program is impaired.

.12 *Conflict of Interest.* A reviewing firm or a review team member should not have conflicts of interest with respect to the reviewed firm or to those of its clients that are the subject of engagements reviewed.

The personnel of a reviewing firm and the reviewing firm itself are not precluded from owning securities of clients of the reviewed firm. However, since confidential information may be obtained during the course of a review, a review team member shall not own securities of a reviewed firm's client that is the subject of an engagement reviewed by that member. In addition, the effect of family relationships (close kin, remote kin) and other relationships and the possible resulting conflict of interest must be considered when assigning team members to review individual engagements.



.13 *Competence.* Review teams must have knowledge of the type of practice to be reviewed, including expertise in specialized industries in which the reviewed firm practices. In the case of reviews of firms with SEC practices, review teams must have available reviewers for SEC engagements who are knowledgeable of current SEC rules and regulations.

In determining the composition of a review team, consideration should be given to the areas to be reviewed and the expertise required for various segments of the review.

.14 *Due Care.* Due care is to be exercised by the review team in the performance of the review and in the preparation of the report. Due care for quality control compliance reviews imposes an obligation on each review team member to fulfill assigned responsibilities in a professional manner similar to that of an independent auditor examining financial statements.

#### ***Organization of the Review Team***

.15 A review team may be (1) appointed by the AICPA Quality Control Standards Committee, (2) formed by a CPA firm engaged by the firm under review, or (3) appointed by another entity which, with the approval of the Quality Control Standards Committee, administers the program for the committee, such as a state society of CPAs.<sup>7</sup>

.16 A review team is headed by a team captain who directs the organization and conduct of the review, supervises other reviewers, and is responsible for preparation of a report on the review. The review team captain is to be a partner currently involved in the audit function.<sup>8</sup> In some larger review engagements, it may be useful for the team captain to designate other partners to serve with the team captain as an executive or supervisory committee for the review and to participate in evaluating the findings of the review team. In the case

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<sup>7</sup> On September 17, 1977, the AICPA Council resolved that the form of independent review contemplated by Council in the program can be met by reviews conducted under the auspices of associations of CPA firms so long as the reviews are conducted under criteria for such purpose developed by a special committee and approved by the AICPA Board of Directors. These criteria are set forth in the Report of the Special Committee on Criteria for CPA Firm Association Reviews, which has been approved by the Board of Directors.

<sup>8</sup> As used in this section, *partner* refers to an individual who is at the partner level in a CPA firm, is a partner, a sole practitioner, or is in an equivalent position with a professional corporation.

of a multioffice firm, the reviewers visiting a selected practice office are under the direction at that location of a partner currently involved in the audit function who supervises the conduct of the review and the work performed at that location (subject to the overall direction of the team captain).

.17 The work of review teams at each organizational level of the reviewed firm should be supervised by a partner.

### ***Qualifications for Individuals to Serve as Reviewers***

.18 The nature and complexity of a compliance review requires the exercise of professional judgment. Accordingly, individuals serving as reviewers shall be CPAs and shall possess current knowledge of accounting and auditing matters. A reviewer shall be currently active at a supervisory level in the accounting and auditing function with a CPA firm, for example (1) as a partner or manager with a CPA firm, (2) in an equivalent supervisory position with a professional corporation, or (3) as a sole practitioner.

.19 In situations where required by the nature of the reviewed firm's practice, a consultant to the reviewers may be used. Consultants should be individuals with expertise in specialized areas but need not be CPAs. For example, computer specialists, statistical sampling specialists, actuaries, or educators expert in professional development may participate in certain segments of the review.

### ***Qualifications for a Reviewing Firm***

.20 When a CPA firm is requested to perform a compliance review engagement, the criteria discussed below should be considered by the firm in determining its capability to perform the compliance review prior to accepting the engagement. Individuals selected by the CPA firm to participate as review team members in a review engagement should possess the requisite qualifications for reviewers or consultants.

.21 *Participating Firm.* A reviewing firm shall be a participant in the program.<sup>9</sup>

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<sup>9</sup> The program provides that, since no firm can be a participating firm at the inception of the program or until the expiration of an interim period described in the program, the requirement that a reviewing firm be a participant in the program is not applicable prior to, or during the interim period. During the interim period, however, a reviewing firm shall have filed a letter of intent to participate in the program before issuing a report under the program.

**.22 Capability.** A reviewing firm must determine its capability to perform a compliance review. The reviewing firm must have available to it reviewers with appropriate levels of expertise and experience to perform the review. Prior to accepting an engagement, the reviewing firm should obtain information about the firm to be reviewed, including certain operating statistics pertaining to size and type of practice.

In determining its capability to perform the engagement, the reviewing firm should consider the size of the firm to be reviewed in relation to its own size. A reviewing firm must recognize that the performance of a compliance review may demand substantial commitments of time, especially from its supervisory accounting and auditing personnel. Therefore, a firm should consider carefully the number and availability of supervisory personnel in determining whether it is capable to perform a compliance review of another firm.

In some instances, a reviewing firm may use a correspondent firm to perform a portion of a compliance review engagement. In such cases, the principal reviewing firm must

(1) be satisfied as to the capability of the correspondent (2) assume responsibility for the work performed by the correspondent, (3) adopt appropriate measures to assure the coordination of its activities with the correspondent, and (4) make arrangements to satisfy itself as to the work performed by the correspondent. The report on the review should not make a reference to a correspondent firm's participation in the review. In order to determine its capability to perform its portion of a compliance review, a correspondent firm should also consider the requirements discussed herein prior to accepting an engagement.

### ***The Field Review***

**.23** The field review should include the following:

1. A study and evaluation of the reviewed firm's quality control system.
2. Review for compliance with a reviewed firm's quality control policies and procedures by—
  - Review at each organizational or functional level within the firm.
  - Review of selected engagement working paper files and reports of the firm.
3. Preparation of a written report on the results of the review.

.24 For a multioffice firm, the review would include visits to the firm's executive office and selected regional and practice offices.

.25 Prior to commencement of the review, the parties to the review may wish to document formally the terms and conditions of the engagement.

.26 *Scope of the Review.* The scope of the review should cover a firm's accounting and auditing practice. (See footnote 2.) Other segments of a firm's practice, such as providing tax services or management advisory services, are not encompassed by the scope of the review except to the extent they are associated with financial statements (for example, reviews of tax provisions and accruals contained in financial statements are included in the scope of the review).

The review should cover a current period (generally one year) to be mutually agreed upon by the reviewed firm and the review team. It is anticipated that quality control policies and procedures may be revised, updated, or amended during the period under review to recognize changing conditions and new professional standards. The scope of the review should encompass the quality control policies and procedures in effect and compliance therewith for the period under review. Client engagements subject to selection for review would be those with years ending during the period under review unless a more recent report has been issued at the time the review team selects engagements.

The review will be directed to the professional aspects of the reviewed firm's accounting and auditing practice; it will not include business aspects of that practice. It may be difficult, however, to distinguish between these aspects of the practice since they may overlap. For example, in evaluating whether the supervision of an engagement was adequate, review team members would consider budgeted and actual time spent for the engagement by various categories or classifications of personnel but would not inquire as to fees billed to the client or the relationship of fees billed to time accumulated at usual or standard billing rates.

Further, when reviewing policies and procedures for advancement, review team members would concern themselves with whether professional personnel were promoted based on demonstrated competence and whether criteria for admission of individuals to the firm give appropriate weight to professional qualifications but would not review compensation of professional personnel.

Review team members will not have contact with, or access to, any client of the reviewed firm in connection with the review.

A reviewed firm may have legitimate reasons for not permitting the working papers for certain engagements to be reviewed. For example, the financial statements of an engagement may be the subject of litigation or investigation by a governmental authority or the firm may have been advised by a client that it will not permit the working papers for its engagement to be reviewed. The review team should satisfy itself as to the reasonableness of the explanation; if the team is not satisfied, the matter should be reported to the reviewed firm's managing partner, and the review team should consider what other action may be appropriate in the circumstances. If the engagements so excluded from the review process are few in number and the review team concludes, by review of additional engagements in a similar area of practice and by review of other work of supervisory personnel who participate in the excluded engagements, that the engagements so excluded do not materially affect the review coverage, then the review team ordinarily would conclude that the scope of the review had not been unduly restricted.

The field review should be concerned with the accounting and auditing engagements performed by the United States offices of the reviewed firm selected for review and supervision and control of work performed on engagements outside the United States. The reviews of engagements should usually be directed toward the accounting and auditing work performed by the practice offices visited and not to a review of work performed by all practice offices of the reviewed firm connected with a particular engagement. Accordingly, in reviewing a selected practice office, the accounting and auditing work performed by that practice office includes work performed for another office of the reviewed firm, for a correspondent firm, or for an affiliated firm.

For those situations in which engagements selected in the practice office reviewed include use of the work of another office, correspondent, or affiliate (domestic or international), the review team would normally limit its review to the portion of the engagement performed by the selected practice office. The review, however, should include instructions for the engagement issued by the reviewed office to another office of the firm, correspondent, or affiliate. In addition, the review should also encompass the procedures by which the reviewed office maintains control over the engagement through supervision (including visits by its supervisory personnel to other locations) and review of work performed by other offices, correspondents, or affiliates.

There may be situations when information available to the review team is insufficient for it to evaluate whether the reviewed firm's

quality control policies and procedures have been applied in supervising engagements performed by other offices or firms. In these instances, it will be necessary at least to obtain documentation from such other offices or firms; usually this may be accomplished by forwarding the requested information to the reviewed office.

*.27 Background Information.* The review team should obtain background information from the reviewed firm, some of which will have been obtained before the engagement was accepted. The information is used as a guide for planning purposes (including selection of offices to be visited and engagements to be reviewed) and should relate to the reviewed firm's accounting and auditing practice. The statistical information may be in terms of approximate amounts or estimates. The following are examples of background information that may be obtained from the reviewed firm:

1. Description of the firm's organization (an organization chart may be useful).
2. Firm philosophy including matters such as—
  - a. Firm goals or objectives.
  - b. Operating practices regarding service to clients and development of personnel.
  - c. Policies relating to industry specialization or practice specialists.
  - d. Operating autonomy of practice offices (the extent of decentralization of authority).
3. Firm profile. (If the reviewed firm is a multioffice firm, the information should be broken out by individual practice office. Offices that are a part of a larger practice unit may be grouped together.)
  - a. Size—accounting and auditing hours. (If such an analysis is not available, the reviewed firm may analyze total billings by function, or make an estimate of the percentage of accounting and auditing work.)
  - b. Number of professional accounting and auditing personnel analyzed by level.
  - c. Number of accounting and auditing clients classified by "audited" and "unaudited" and by type—publicly held, privately held, or not for profit.
  - d. Firm management level personnel analyzed by years with the firm and areas of expertise.

- e. Industry concentrations and specialty practice areas, such as SEC or regulated industries.
- f. Extent of use of correspondent firms on engagements.
- g. Extent of international practice.
- h. Description of recent mergers.
- i. Newly opened offices.

**.28 Study and Evaluation of the Quality Control System.** After the background information is obtained and studied, the review team should commence its study and evaluation of the reviewed firm's quality control system. The objective of the study is to evaluate whether the quality control policies and procedures are appropriately comprehensive and suitably designed for the reviewed firm, are adequately documented, and the procedures for communicating them to professional personnel are appropriate. This evaluation of comprehensiveness and suitability should be considered further by the review team in the course of the review and may be modified by the review team based on the results of its other review and compliance testing procedures.

The reviewed firm's quality control policies and procedures should be considered in relation to the guidance material contained in *Quality Control Policies and Procedures for Participating CPA Firms*. This process assists the review team in evaluating whether the reviewed firm has given adequate consideration to, and adopted, appropriately comprehensive and suitably designed policies and procedures for each of the elements of quality control to the extent they are applicable to its practice.

If significant apparent deficiencies are identified in the reviewed firm's quality control policies and procedures, the review team should bring them to the attention of the reviewed firm's managing partner or to another appropriate authority in the firm. The reviewed firm would be given an opportunity to refute or correct such apparent deficiencies. If significant corrective actions are required, the review usually will be suspended for a sufficient period of time for the reviewed firm to develop revised policies or procedures and implement them in its practice. The review team should consider communicating such significant deficiencies to the reviewed firm, generally in writing, at the time the review is suspended. The review team would, in resuming the review, evaluate whether the revised policies or procedures correct the deficiencies.

**.29 Extent of Compliance Tests.** Based on its study and evaluation of the reviewed firm's quality control system, the review team should

develop programs to test compliance.<sup>10</sup> The programs for compliance tests should be tailored to the practice of the firm under review and should be sufficient to evaluate whether the reviewed firm's quality control policies and procedures have been adequately communicated to professional personnel and are being complied with. The nature and extent of testing should take into account the review team's evaluation of the relative strengths and weaknesses of the reviewed firm's quality control policies and procedures. Some of these compliance tests would be performed at practice offices selected for review, some on a firm-wide basis, and others on an individual engagement basis. These tests may take the form of—

- Inquiries of persons responsible for a function or activity.
- Review of selected administrative and personnel files.
- Interviews with firm professional personnel at various levels.
- Review of the results of the firm's inspection function.
- Review of selected engagement working paper files and reports.
- Review of other evidential matter.

.30 *Location of Documentation*—The review team should determine the work to be accomplished at the reviewed firm regarding compliance with quality control policies and procedures and the location of related documentation, which may be maintained in functional or administrative files. In the case of a multioffice firm, attention should be directed to a review of documentation maintained at the executive office. For example, the executive office probably has statistics, records, and other data relative to procedures regarding client acceptance and continuance, hiring, training, promotion, and independence and may also have data useful in evaluating compliance with the firm's quality control policies and procedures for consultation and inspection.

.31 *Selection of Offices*—The process of office selection is not subject to definitive criteria; visits to practice offices should be sufficient to enable the review team to evaluate whether the reviewed firm's quality control policies and procedures are adequately communicated to professional personnel and are being complied with.

In selecting both the number and location of practice offices to be visited, the review team should consider the reviewed firm's pre-

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<sup>10</sup> The AICPA is preparing program guidelines for use by committee-appointed review teams.



viously furnished background information. The practice offices selected should be generally representative of the reviewed firm's accounting and auditing practice and, accordingly, should provide a cross section of offices, giving consideration to their size and geographic distribution. In addition, consideration should be given to the selection of recently merged or recently opened offices.

The number and location of practice offices to be selected will require the exercise of judgment by the review team. Considerations which may affect the number and location of practice offices selected for review would include (1) degree of centralization of accounting and auditing practice control and supervision, (2) significance of specialized industry practice, and (3) the review team's evaluation of the scope and adequacy of the reviewed firm's inspection program.

Although the foregoing considerations preclude definitive guidelines, Exhibit A has been developed to assist a review team in selecting offices in the review of a multioffice firm.

**.32 Selection of Engagements**—The segment of the firm's accounting and auditing practice reviewed should be sufficient to provide the review team with reasonable assurance for its conclusions regarding the appropriateness or suitability of the reviewed firm's quality control system and compliance therewith.

The review team should select the engagements to be reviewed for each practice office to be visited based on accounting and auditing practice statistics and other data. If not previously obtained, the review team may wish to obtain information such as the names of clients, types of industries, client size (for example, revenues, assets), whether the client is publicly held, privately held or not for profit, the number of engagement hours, and names of the partner and supervisory personnel associated with the engagements.

Engagements selected for review should provide a reasonable cross section of the reviewed office's accounting and auditing practice; however, greater weight should be given to selecting engagements for publicly held clients in view of the public interest in these companies. An effort should be made to include engagements of most of the partners and other supervisory personnel in the reviewed office and to provide a diversity of types of engagements.

The number of engagements to be selected or the percentage of the firm's accounting and auditing hours to be reviewed will be affected by the size and nature of the reviewed firm's practice as well as the method of selection employed by the review team. Although these considerations preclude definitive guidelines, Exhibit B has been

developed to assist a review team in determining judgmentally the number of engagements or accounting and auditing hours to be reviewed.

.33 *Extent of Engagement Review.* The objectives of the review of engagements are to evaluate (1) whether there has been compliance by the reviewed firm with its quality control policies and procedures and (2) whether the quality control policies adopted and procedures established by the reviewed firm are appropriately comprehensive and suitably designed for its accounting and auditing practice. To the extent necessary to achieve these objectives, the review of engagements should include review of financial statements, accountants' reports, working papers, and correspondence and should include discussion with professional personnel of the reviewed firm. The depth of review of working papers for particular engagements is left to the judgment of the reviewers; however, the review is directed primarily to the key areas of an engagement to determine whether, in accordance with the reviewed firm's quality control policies and procedures, there were well-planned, appropriately executed, and suitably documented procedures that were performed on the engagement.

In connection with these engagement reviews, the review team may encounter indications of significant failures by the reviewed firm to reach appropriate auditing and reporting conclusions. In such situations, the review team should consider that it has not made an examination of financial statements in accordance with generally accepted auditing standards, nor does it have the benefit of access to client records, discussions with a client, or specific knowledge of a client's business. Therefore, in the absence of compelling evidence to the contrary, the review team should presume that representations concerning facts contained in the working papers are correct. The review team should, however, pursue questions about auditing or reporting matters with the reviewed firm when it believes there may be a significant failure to reach appropriate conclusions in the application of professional standards, which include generally accepted auditing standards and generally accepted accounting principles.

The review team should consider whether significant failures to reach appropriate auditing and reporting conclusions are indicative of significant deficiencies of the reviewed firm in complying with its quality control policies and procedures or of significant inadequacies in those policies and procedures. The pattern, pervasiveness, and significance of the failures noted should be considered by the review

team in making its overall evaluation of the reviewed firm's system of quality control and compliance therewith.

Should the review team, during the conduct of the review, believe that the reviewed firm may have issued an inappropriate report on a client's financial statements, the review team captain shall promptly inform an appropriate authority within the reviewed firm. In such circumstances, it is the responsibility of the reviewed firm to determine what action should be taken.<sup>11</sup>

### ***Completion of the Review***

.34 Prior to issuance of its report, the review team should communicate its conclusions to the reviewed firm. This communication would ordinarily take place at a meeting attended by the review team captain, the executive or supervisory committee (if applicable) and in-charge or other reviewers, as appropriate, and by appropriate individuals from the reviewed firm. The parties would discuss the review team's conclusions and any resulting impact on the opinion to be issued, recommendations (if any) for improvements in the reviewed firm's quality control policies and procedures, and other relevant matters. The reviewed firm may decide to have recommendations for improvement furnished in writing by the review team captain.

.35 For the review of a multioffice firm, the review team for a practice office would, in addition to the communication described in the preceding paragraph, normally communicate the findings of its review to appropriate individuals at the office reviewed.

### ***Review Team Working Papers***

.36 The review team captain should furnish instructions to the review team concerning the manner in which working papers relating to the review are to be prepared during the course of the review to facilitate summarization by the review team captain in completing the review.<sup>12</sup>

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<sup>11</sup> See *Codification of Auditing Standards and Procedures*, SAS No. 1 (New York: AICPA, 1973), sec. 561 [AU section 561].

<sup>12</sup> For reviews conducted by a committee appointed review team under the program, working papers are retained only until such time as the report on the review has been filed with the AICPA or the period for filing the report has elapsed, whichever is earlier.

## **Reporting on Quality Control Compliance Reviews**

### ***The Review Team's Report***

.37 The program provides that, upon completion of a quality control compliance review, the review team communicate its findings to the reviewed firm and promptly submit a written report to the reviewed firm. In order for the reviewed firm to become a participating firm in the program or to continue as a participant, a report acceptable for participation in the program (see below) must be submitted by the reviewed firm to the AICPA. Failure to file an acceptable report will result in the reviewed firm's not becoming or not continuing as a participant in the program.

.38 The report should be addressed to the partners, proprietor, stockholders, or officers of the reviewed firm. A report issued by a review team appointed by the Quality Control Standards Committee, or by another entity that administers the program for the committee, should be signed by the review team captain (without reference to the captain's firm) and should contain the name of the review team's originating organization (such as the AICPA or state society of CPAs). A report by a review team formed by a CPA firm should be issued on the reviewing firm's letterhead and signed by the firm. The report should be dated as of the completion of the review.

.39 The reviewed firm may advise its clients and its personnel of the results of the review and indicate that the report is on file at the AICPA. Copies of the report may also be made available by a reviewed firm to its clients, its personnel, and others.

### ***Report Acceptable for Participation in the Program***

.40 A report issued by a review team that is acceptable for participation in the program (an "acceptable report") contains a statement of the scope of the review, a description of the general characteristics of a system of quality control, and the opinion (without qualification) of the review team that the reviewed firm's quality control system was appropriately comprehensive and suitably designed for the firm, adequately documented, communicated to professional personnel, and was being complied with to provide the firm with reasonable assurance of conforming with the standards of the profession for firms participating in the program.

.41 An example of an acceptable report is presented as Exhibit C of this section.

### ***Reporting Considerations***

.42 The review team's evaluation of whether a reviewed firm's quality control system and compliance therewith conform with the guidelines of the profession requires both an understanding of the elements of quality control and the exercise of professional judgment regarding their application to an accounting and auditing practice. Because of the absence of quantitative measurement criteria, the evaluation of the significance of perceived deficiencies in the system of quality control or compliance therewith may be more difficult than the evaluation of the materiality of exceptions noted in financial reporting matters. In determining whether a review team will issue an acceptable report, the review team should consider factors such as those that follow.

.43 *Deficiencies.* The deficiencies noted should be considered for their significance in relation to the reviewed firm's (1) quality control policies and procedures, (2) organizational structure, and (3) nature of practice.

A deficiency noted in certain quality control policies and procedures may be partially or wholly offset by other policies or procedures. The review team should consider the interrelationships among the elements of quality control and weigh deficiencies against other compensating policies and procedures.

.44 *Compliance.* Compliance, as used in this section, means adherence to a prescribed policy or procedure in the substantial majority of situations; it does not imply adherence to a prescribed policy or procedure in every case. Variance in individual performance and professional interpretation affects the degree of compliance with a firm's prescribed quality control policies and procedures. Adherence to all policies and procedures in every case may not be possible; nevertheless, a high degree of compliance is to be expected. The review team should consider the nature, significance, and frequency of instances of noncompliance noted in the review in evaluating whether the reviewed firm has complied with its quality control policies and procedures in the substantial majority of situations or whether modification of the review team's report is required.

In considering instances of noncompliance with prescribed quality control policies and procedures that could affect the review team's report, the review team should discuss with the reviewed firm whether the quality control policies and procedures in question exceed policies and procedures that would be required in the circumstances to achieve the objectives of a quality control system and par-

ticipation in the program. In such instances, if the review team concludes that the quality control policies and procedures in question exceed those required for participation in the program, its report should be based on compliance by the reviewed firm with those policies and procedures required to provide the firm with reasonable assurance of conforming with the standards of the profession for firms participating in the program.

***Circumstances Resulting in a Report Unacceptable for Participation in the Program***

.45 Circumstances that ordinarily would result in an unacceptable report for purposes of participation in the program are as follows:

1. The scope of the review is limited by conditions that preclude the application of one or more review procedures considered necessary.
2. The review discloses significant deficiencies (see discussion of "deficiencies" above) in the quality control policies and procedures prescribed for the firm's accounting and auditing practice.
3. The review discloses a significant lack of compliance (see discussion of "compliance," above) with the firm's quality control policies and procedures.

.46 In those instances in which the review team determines that an unacceptable report is required, the reasons should be adequately disclosed.

***Engagements Discontinued Prior to Completion***

.47 In the event that a review is discontinued prior to completion, the review team should consider advising the reviewed firm in writing of the discontinuance. The review team may wish to communicate any major concerns to the reviewed firm.

***Disagreement Within Committee-Appointed Review Teams***

.48 A disagreement regarding the type of report to be issued may arise among members of an executive committee or supervisory committee (where applicable) or among review team members who have knowledge of the overall findings of the review. When review team members are unable to resolve such a disagreement, the matter

should be referred to the Quality Control Standards Committee of the AICPA for resolution.<sup>18</sup>

## Exhibits

.49 These guidelines have been developed for guidance to review teams in the initial period of implementation of the program and are subject to review at a subsequent time to determine whether modifications are appropriate in the light of experiences in practice.

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### Exhibit A: Guidelines for Selection of Offices

The following guidelines, which should be read in conjunction with guidance on selection of offices included in the accompanying guide, may be considered for reviews of multioffice firms:

<i>Number of offices in reviewed firm</i>	<i>Approximate number of offices to be selected for review</i>
2 to 15	Largest office plus 1 to 3 offices
over 15	15% to 25% of the reviewed firm's offices (the selected offices should contain similar percentages of the firm's professional personnel and the firm's accounting and auditing hours)

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### Exhibit B: Guidelines for Accounting and Auditing Hours to be Reviewed

The following guidelines may be considered in determining judgmentally the percentage of a reviewed firm's total accounting and auditing hours to be selected for review:

<i>Number of offices in reviewed firm</i>	<i>Percentage of reviewed firm's total accounting and auditing hours to be reviewed</i>
1 to 15	5% to 10%
over 15	3% to 6%

<sup>18</sup> The program provides a means for resolving disagreements between a review team and a reviewed firm.

For example, if three offices of a ten-office firm were selected for review, engagements selected for review in those three offices should represent between 5 percent and 10 percent of the reviewed firm's total accounting and auditing hours.

The time required to review selected individual engagements is subject to variation depending on the size, nature, and complexity of the engagement, including engagements in specialized industries. For example, review time for smaller engagements generally may be expected to be proportionally greater than that required for larger engagements in relation to total hours for those engagements.

In performing the engagement review portion of the review, it can be anticipated that the time required by the review team for review of all engagements selected may be expected to vary from 1 percent to 3 percent of the aggregate hours incurred by the reviewed firm to perform these engagements.

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### **Exhibit C: Report Acceptable for Participation in the Program**

To the Partners  
Jones, Smith & Co.

We have reviewed the system of quality control for the accounting and auditing practice of Jones, Smith & Co. in effect for the (period) ended June 30, 1978. Our review was conducted in conformity with guidelines for quality control compliance reviews promulgated under the Voluntary Quality Control Review Program for CPA Firms of the American Institute of Certified Public Accountants. We tested compliance with the firm's quality control policies and procedures [at the firm's executive office and at selected practice offices in the United States]<sup>1</sup> to the extent we considered appropriate. These tests included the application of the firm's policies and procedures on selected accounting and auditing engagements. [We tested the supervision and control of portions of engagements performed outside the United States.]<sup>2</sup>

A firm's system of quality control encompasses its organizational structure and the policies adopted and procedures established to

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<sup>1</sup> To be included, as appropriate, for reviews of multioffice firms.

<sup>2</sup> To be included for reviewed firms with offices, correspondents, or affiliates outside the United States. Appropriately modified wording should be used if the reviewed firm uses correspondents or affiliates domestically, if significant to the scope of the review.



provide the firm with reasonable assurance of conforming with the standards of the profession in the conduct of its accounting and auditing practice. Standards of the profession are expressed in terms of broad concepts and objectives rather than detailed procedures, and their application requires the exercise of professional judgment in a variety of circumstances. The extent of a firm's quality control policies and procedures and the manner in which they are implemented will depend upon a variety of factors such as the size and organizational structure of the firm, the nature of its practice, and its philosophy as to the degree of operating autonomy appropriate for its people. Variance in individual performance and professional interpretation affects the degree of compliance with a firm's prescribed quality control policies and procedures; therefore, adherence to all policies and procedures in every case may not be possible, but compliance does require adherence to prescribed policies or procedures in the substantial majority of situations. In performing our review, we have given due regard to the foregoing conditions.

In our opinion, the system of quality control for the accounting and auditing practice of Jones, Smith & Co. for the (period) ended June 30, 1978, was appropriately comprehensive and suitably designed for the firm, adequately documented, communicated to professional personnel, and was being complied with during the period to provide the firm with reasonable assurance of conforming with the standards of the profession for firms participating in the Voluntary Quality Control Review Program for CPA Firms of the American Institute of Certified Public Accountants.

City, State  
Date

William Brown  
Team Captain  
AICPA Review  
Team

[ for review by  
AICPA review  
team ]

Johnson & Co.

[ for review by  
a firm ]